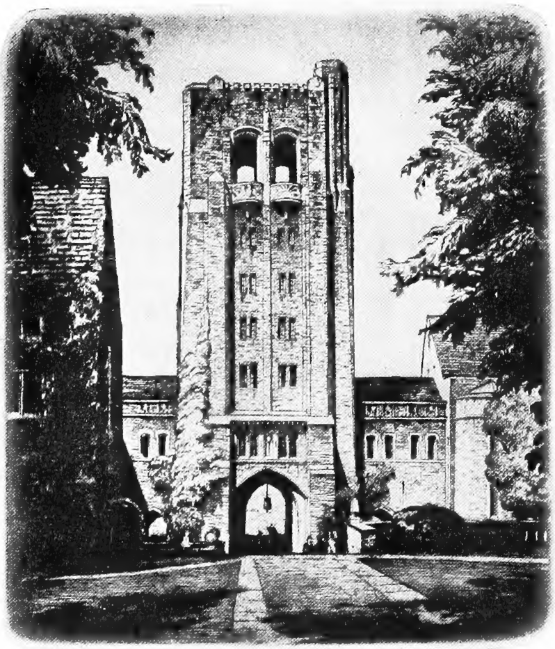

Cornell Law School Library

COMMENTARIES

ON THE LAW OF

PRIVATE CORPORATIONS

BY

SEYMOUR D. THOMPSON, LL. D.

IN SIX VOLUMES.

VOLUME II.

SAN FRANCISCO:
BANCROFT-WHITNEY COMPANY.
1895.

TRADE MARK

CONTENTS OF VOLUME II.

TITLE TWO.

(CONTINUED.)

CAPITAL STOCK AND SUBSCRIPTIONS THERETO.

CHAPTER XXIII.

CONDITIONAL STOCK SUBSCRIPTIONS.

ARTICLE I. VALIDITY OF CONDITIONAL SUBSCRIPTIONS.

ARTICLE I. GENERAL PRINCIPLES.

ARTICLE II. WHAT FRAUDS WILL AND WHAT WILL NOT AVOID THE CONTRACT.

ARTICLE III. REMEDIES OF THE DEFRAUDED SHAREHOLDER AGAINST THE COMPANY.

ARTICLE IV. TIME WITHIN WHICH A RESCISSION MUST BE CLAIMED.

ARTICLE V. REMEDIES AGAINST PERSONS GUILTY OF THE FRAUD.

ARTICLE VI. FRAUDULENT ISSUES AND OVERISSUES.

CHAPTER XXV.

THE SURRENDER OF SHARES AND RELEASE OF SHAREHOLDERS.

CHAPTER XXVI.

PAYMENT OF SHARES.

ARTICLE I. IN GENERAL.

ARTICLE II. PAYMENT IN PROPERTY.

ARTICLE III. IN WHAT KIND OF PROPERTY.

ARTICLE IV. NEW DOCTRINE THAT A CORPORATION CAN GIVE AWAY ITS UNISSUED SHARES.

ARTICLE V. RIGHTS OF BONA FIDE PURCHASERS OF UNPAID SHARES.

ARTICLE VI. MISCELLANEOUS HOLDINGS.

CHAPTER XXVII.

ASSESSMENTS AND CALLS.

ARTICLE I. IN GENERAL.

ARTICLE II. CONDITIONS PRECEDENT: FULL SUBSCRIPTION — ORGANIZATION.

ARTICLE III. SUFFICIENCY AND NOTIFICATION OF THE ASSESSMENT.

TITLE THREE.

REMEDIES AND PROCEDURE TO ENFORCE SHARE SUBSCRIPTIONS.

CHAPTER XXVIII.

FORFEITURE OF SHARES FOR NONPAYMENT OF ASSESSMENTS

ARTICLE I. POWER TO FORFEIT AND HOW EXERCISED.

ARTICLE II. EFFECT OF SUCH FORFEITURES.

ARTICLE III. RELIEF AGAINST SUCH FORFEITURES.

CHAPTER XXIX.

ACTIONS BY THE CORPORATION AGAINST SHAREHOLDERS FOR ASSESSMENTS

Article I. Parties.

Article II. Pleading.

Article III. Miscellaneous.

CHAPTER XXX.

EVIDENCE IN SUCH ACTIONS.

Article I. Evidence of Corporate Existence.

ARTICLE II. CONDUCT SHOWING MEMBERSHIP: ESTOPPELS.

ARTICLE III. BOOKS AND RECORDS OF CORPORATION AS EVIDENCE.

ARTICLE IV. OTHER EVIDENCE OF MEMBERSHIP.

ARTICLE V. OTHER POINTS OF EVIDENCE.

CHAPTER XXXI.

DEFENSES TO ACTIONS FOR ASSESSMENTS.

CHAPTER XXXII.

LIMITATIONS OF ACTIONS AGAINST STOCKHOLDERS.

ARTICLE I. GENERAL DOCTRINES.

ARTICLE II. WHEN THE STATUTE BEGINS TO RUN.

ARTICLE III. QUESTIONS UNDER SPECIAL STATUTES.

TITLE FOUR.

SHARES CONSIDERED AS PROPERTY.

CHAPTER XXXIII.

POWERS OF THE CORPORATION IN RELATION TO ITS OWN SHARES.

CHAPTER XXXIV.

INCREASING AND DECREASING CAPITAL STOCK.

ARTICLE I. INCREASING CAPITAL STOCK.

ARTICLE II. REDUCING CAPITAL STOCK.

CHAPTER XXXV.

DIVIDENDS.

ARTICLE I. GENERALLY.

ARTICLE II. VALIDITY AND PROPRIETY OF DIVIDENDS.

ARTICLE III. STOCK AND SCRIP DIVIDENDS.

ARTICLE IV. RIGHT TO DIVIDENDS AS BETWEEN SUCCESSIVE OWNERS OF SHARES.

ARTICLE V. RIGHT TO DIVIDENDS AS BETWEEN LIFE TENANT AND REMAINDERMAN.

ARTICLE VI. REMEDIES TO COMPEL PAYMENT OF DECLARED DIVIDENDS.

CHAPTER XXXVI.

INTEREST-BEARING, PREFERRED AND GUARANTEED STOCK.

ARTICLE I. INTEREST-BEARING STOCK.

ARTICLE II. ISSUING PREFERRED STOCK.

ARTICLE III. RIGHTS OF PREFERRED SHAREHOLDERS.

ARTICLE IV. REMEDIES OF PREFERRED SHAREHOLDERS.

CHAPTER XXXVII.

TRANSFERS OF SHARES.

ARTICLE. I. RIGHT OF ALIENATION.

ARTICLE II. LIEN OF CORPORATION ON ITS SHARES.

ARTICLE III. NATURE OF SHARE CERTIFICATES.

ARTICLE IV. FORMALITIES: REGISTRATION.

ARTICLE V. UNREGISTERED TRANSFERS.

ARTICLE VI. PRIORITIES AS BETWEEN ATTACHING CREDITORS AND UNRECORDED TRANSFEREES.

ARTICLE VII. COMPELLING TRANSFERS IN EQUITY.

ARTICLE VIII. MANDAMUS TO COMPEL TRANSFERS.

Article IX. Action at Law for Refusal to Register.

Article X. Measure of Damages for Refusing to Transfer.

Article XI. Fiduciary Relation Between Company and Stockholder.

ARTICLE XII. ITS LIABILITY FOR WRONGFUL TRANSFERS.

ARTICLE XIII. ITS DUTIES AND RESPONSIBILITIES WHERE CERTIFICATES HAVE BEEN LOST OR STOLEN.

Article XIV. Transfers of Shares Held in Trust.

Article XV. Liable for Transferring on Forged Powers of Attorney.

SUBDIVISION I. Liability to the Original Shareholder.

SUBDIVISION II. Liability to Bona Fide Sub-purchaser.

SUBDIVISION III. Miscellaneous Holdings.

CHAPTER XXXVIII.

BONA FIDE PURCHASERS OF SHARES.

ARTICLE I. IN GENERAL.

ARTICLE II. WHO ARE SUCH PURCHASERS.

CHAPTER XXXIX.

PLEDGES AND MORTGAGES OF SHARES.

ARTICLE I. NATURE AND INCIDENTS OF THE CONTRACT.

ARTICLE II. VALIDITY AS AGAINST THIRD PARTIES.

ARTICLE III. RETURNING THE IDENTICAL CERTIFICATE

ARTICLE IV. ENFORCING THE CONTRACT

ARTICLE V. ACTIONS BY THE PLEDGOR FOR CONVERSION OF THE SHARES.

CHAPTER XL.

OTHER DEALINGS IN SHARES.

ARTICLE I. DEALINGS WITH AND THROUGH BROKERS.

ARTICLE II. "OPTIONS," "FUTURES," "STRADDLES."

ARTICLE III. LOANS.

ARTICLE IV. SALES.

Article V. Warranties.

Article VI. Other Dealings.

CHAPTER XLI.

EXECUTION AND ATTACHMENT AGAINST SHARES.

Article I. In General.

ARTICLE II. PROCEDURE.

CHAPTER XLII.

TAXATION OF SHARES AND DIVIDENDS.

ARTICLE I. GENERAL CONSIDERATIONS.

ARTICLE II. DOUBLE TAXATION IN RESPECT OF SHARES.

ARTICLE III. EXEMPTIONS FROM TAXATION.

ARTICLE IV. SITUS OF SHARES FOR THE PURPOSE OF TAXATION.

ARTICLE V. TAXATION OF SHARES IN NATIONAL BANKS.

Article VI. Taxation of Dividends.

Article VII. Questions Relating to Assessment and Collection.

CHAPTER XXIII.

CONDITIONAL STOCK SUBSCRIPTIONS.

ARTICLE I. VALIDITY OF CONDITIONAL SUBSCRIPTIONS.

§ 1305. Conditions Imposed by the Charter. — Conditions imposed by the organic law of the corporation enter into and form a part of the contract.[1] When, therefore, the charter

[1] *Ante*, §§ 1091, 1137.

requires the enterprise to be completed within a certain time, otherwise the franchises granted to be null and void, if it is not completed by that time the subscribers are released, notwithstanding an amendment to the charter, procured subsequently to the contract of subscription, extending the time, unless the subscriber assists in procuring the amendment, or assents thereto.[1]

§ 1306. **View that Conditional Subscriptions are Void.**— There is a difference of opinion on the question of the validity of a conditional subscription to the shares of stock of corporations organized to build railroads, or plank roads, or for other public purposes. It has been held, in cases chiefly turning on the language of local statutes, and, for the most part, where the subscriptions were made prior to the formation of the corporations, that conditional subscriptions are void, because *contrary to public policy*,[2] or to the charter or other statute under which they are taken. But a subscription to a fund to be donated to a railroad company,— not being a subscription to its stock — provided it will build a bridge at a certain point, has been held valid and enforceable.[3] Nor does this principle apply to a condition that the subscription shall not be enforceable until the full amount intended to be raised shall have been subscribed. On the contrary, such a condition is a condition precedent, which must be performed before an action can be made thereon.[4]

§ 1307. **Because not Concurrent and hence not Obligatory on Each at the Same Time.**— The validity of such subscriptions has been denied on the further ground that the contract, in order to be binding, must be "concurrent and obligatory on each at the same time."[5] The theory seems to be that, as the corpora-

[1] Union Hotel Co. *v.* Hersee, 15 Hun (N. Y.), 371; *Ante*, §§ 1273, 1296.

[2] Butternuts Turnp. Co. *v.* North, 1 Hill (N. Y.), 518; Macedon Plank Road Co. *v.* Lapham, 18 Barb. (N. Y.) 318; Ft. Edwards &c. Plank Road Co. *v.* Payne, 15 N. Y. 583. Macedon &c. Plank Road Co. *v.* Snediker, 18 Barb. (N. Y.) 317.

[3] Cumberland Valley R. Co. *v.* Baab, 9 Watts (Pa.), 458: *s. c.* 36 Am. Dec. 132.

[4] Belfast &c. R. Co. *v.* Cottrell, 66 Me. 185; Belfast &c. R. Co. *v.* Moore, 60 Me. 561; Penobscot &c. R. Co. *v.* Dunn, 66 Me. 185; *post*, § 1322.

[5] Macedon &c. Plank Road Co. *v.* Snediker, 18 Barb. (N. Y.) 317. See

tion is not yet *in esse*, and as there is no one authorized by the act of the legislature under which the commissioners are proceeding in taking the subscriptions, to receive them on any condition or on any other terms than those nominated in the statute, the annexing of a condition to the subscription is tantamount to a rejection of the proposal for a contract made by the commissioners, under the statutory authority, in behalf of the intended corporation. But this view does not seem to be tenable, and appears to have been abandoned in later cases, and the better view adopted that, even under such circumstances, a conditional subscription is a *continuing offer* until it is accepted by the corporation on its coming into existence, unless it is withdrawn before such acceptance. The better view is that, when the offer is accepted, the minds of the parties meet and the contract is complete; that the acceptance, when it takes place, constitutes a sufficient legal consideration for the engagement on the part of the subscriber, and places the case in substantially the same situation which it would have occupied if a party had been in existence capable of accepting the offer of the subscriber as and when made, which party had accepted it at the time.[1]

§ 1308. Effect of Illegal Conditions: Whether the Whole Contract Void, or the Condition Merely. — The meaning of the rule above stated must be further explained. The courts which have adopted it have agreed that the condition is void, either because not authorized by the enabling act, or because expressly or impliedly forbidden by it. But they have not agreed on the question what shall be done with the subscription which contains the illegal condition. The New York courts hold, as above seen,[2] that the whole contract is void. This releases the subscriber when sued for assessments. In Pennsylvania, on the other hand, the doctrine is that a subscription to the stock of a corporation, made before letters-patent are issued and an organization effected, must be considered absolute and unqualified, and any

to the principle, Utica &c. R. Co. *v.* Brinckerhoff, 21 Wend. (N. Y.) 139; *s. c.* 34 Am. Dec. 220.

[1] Connecticut &c. R. Co. *v.* Bailey, 24 Vt. 465, 478; *s. c.* 58 Am. Dec. 181; Troy Academy *v.* Nelson, 24 Vt. 189; *ante*, § 1204. See to the principle, Boston &c. Railroad *v.* Bartlett, 3 Cush. (Mass.) 224.

[2] *Ante*, § 1306.

condition attached thereto is void. Commissioners have no authority to raise conditional subscriptions. If they do, the subscription is valid and binding, and the condition null and void.[1] The courts of that State hold that the agreement is severable, so to speak; that the law will enforce so much of it as is valid, and discharge so much of it as is invalid; in other words, that it will discharge the condition, and enforce the contract as an unconditional one.[2] They thus drive the subscriber into a contract which he never made. Whatever reasons may have been given for this conclusion, it proceeds upon the assumption that the subscriber is bound to take notice of the powers of the commissioners, the promoters, or the agents of the corporation, who take the subscription, and that if, through ignorance or otherwise, he inserts in it a condition not warranted by the law under which they proceed, he must perform the contract as an absolute promise. When it is considered how these subscriptions have been obtained in the past, especially to the stock of railroad companies, the gross injustice of this rule is apparent. Astute agents or commissioners have been appointed to canvass the country, and they have been accustomed to hold out all sorts of inducements to ignorant farmers and others to get them to subscribe. These persons do not in fact know, and have not the means of knowing the powers under which such agents or commissioners act, except from their representations. With the concurrence of these commissioners or agents, they consent to subscribe on certain conditions not in themselves wrong or immoral, but not warranted or even forbidden by the law governing the particular corporation. To hold them to such a contract while exonerating the corporation from performing the condition is unjustly to force them into a contract which they

[1] Boyd *v.* Peachbottom Ry. Co., 90 Pa. St. 169. That the *subscription* will be treated as an absolute one, and the *condition* discharged, as a *fraud on the Commonwealth*, see Bavington *v.* Pittsburgh &c. R. Co., 34 Pa. St. 358; Bedford R. Co. *v.* Bowser, 48 Pa. St. 29; Caley *v.* Phila. &c. R. Co., 80 Pa. St. 363. See *post*, § 1309.

[2] Thus, it was held in that State that a subscription to the stock of a railroad company, under the Pennsylvania act of February 19, 1849, made to the commissioners, before the organization of the company, upon condition that the road should be located on a special route, was to be deemed an absolute subscription, without reference to the condition. Pittsburgh &c. R. Co. *v.* Biggar, 34 Pa. St. 455.

never made or intended to make. Not only is it a rule of common justice, but also of severe and undeniable logic, that if A. makes a promise to B. upon a condition which B. cannot perform, there is no contract, and the courts have frequently taken this view.[1] Under this rule the contract stands or falls as an entirety.

§ 1309. **Condition Discharged when a Fraud on the Law, and Contract Absolute.** — A well defined exception exists where the condition is, from its very nature, a fraud on the rights of other subscribers or upon the public, — in other words, where it may be termed *a fraud on the law*. In such cases the illegal condition is discharged, and the subscriber is held as though he had bound himself by an absolute promise.[2] This is well illustrated by a recent case in Tennessee, where it was agreed that the subscriber to the stock of an intended corporation should receive, in consideration of his subscription, bonds of the corporation to the full amount subscribed, secured by a first mortgage upon its property. It was held that a court of equity would neither relieve the subscriber from his subscription nor compel the corporation to perform the condition, but that the subscriber stood absolutely liable to pay for the shares subscribed, both at law and in equity. The court, speaking through Mr. Justice Lurton, among other reasons for this conclusion, said: "It was an arrangement whereby the franchise was to be secured, and at the same time deprive the public of the security which by law they are entitled to have, and upon which the grant of the

[1] Roberts *v.* Mobile &c. R. Co., 32 Miss. 373. In a recent case in Alabama it is held that a contract of subscription entered into upon an understanding that the subscriber is to have five dollars worth of stock for every dollar subscribed, is illegal and void in such a sense that an action cannot be maintained to enforce a contract for a sale of a portion of the subscriber's interest in the stock, — in consequence of a provision of the constitution of that State (Ala. Const. Art. 14, § 6) that no corporation shall issue stock except for money, labor done, or money or property actually received, and all fictitious increase of stock or indebtedness shall be void. Williams *v.* Evans, 87 Ala. 725; 6 L. R. A. 218; 6 South Rep. 702. This decision necessarily involves the conclusion that such a contract is void in its entirety and is hence not assignable; for certainly if the law would merely discharge the illegal condition the subscriber would have some right, by virtue of his contract, which he could both enforce against the corporation and assign. See *post*, § 1319., last note.

[2] *Post*, §§ 1310, 1324. Bavington *v.* Pittsburgh &c. R. Co., 34 Pa. St. 358.

franchise depends. Whatever the real motive and purpose of the promoters of this arrangement may have been, its legal effect, if valid, would have been to throw all the risks and hazards of the business upon the public who should deal with it; while contributors were to reap all possible gains, and should be secured against loss in the event the enterprise prove unprofitable. Is a contract by which a corporation agrees to repay the contributors of its capital stock their several contributions, and whereby such contributions are converted into corporate debts, valid even as against the corporation? Upon what consideration does such an agreement rest? And what power has a corporation to bind itself by such a contract?"[1] The Supreme Court of Illinois proceeded upon similar grounds in a late case where an agreement of subscription provided that the subscriber should pay for the shares in installments, and that when forty per cent. of the par value should be paid in, the shares should be issued as full paid stock. The court held that, notwithstanding the issue of the certificates, the subscriber was liable for the additional sixty per cent.[2]

§ **1310. Explanation of this Principle.**— In an important case in the Supreme Court of the United States this principle was thus explained by Mr. Justice Strong: "It must be conceded that conditions attached to subscriptions for the stock of a railroad company, made before its incorporation, have, in many cases, been held to be void, and the subscriptions have been treated as absolute. The question respecting their validity has most frequently arisen when the condition has been that the proposed road should be located in a specified manner, or over a defined line. But other conditions have been held invalid, and have been disregarded by the courts. The reasons for such a ruling are obvious, and they commend themselves to universal approval. When a company is incorporated under general laws, * * * and the law prescribes that a certain amount of stock shall be subscribed before corporate powers shall be

[1] Morrow *v.* Nashville Iron &c. Co., 87 Tenn, 262, 273; *s. c.* 3 L. R. A. 37; 10 S. W. Rep. 495; 5 Rail. & Corp. L. J. 206.

[2] Great Western Telegraph Co. *v.* Gray, 122 Ill. 630.

exercised, if subscriptions, obtained before the organization was effected, may be subsequently rendered unavailable by conditions attached to them, the substantial requirements of the laws are defeated. The purpose of such a requisition is, that the State may be assured of the successful prosecution of the work, and that creditors of the company may have, to the extent at least of the required subscription, the means of obtaining satisfaction of their claims. The grant of the franchise is, therefore, made dependent upon securing a specified amount of capital. If the subscriptions to the stock can be clogged with such conditions as to render it impossible to collect the fund which the State required to be provided before it would assent to the grant of corporate powers, a charter might be obtained without any available capital. Conditions attached to subscriptions, which, if valid, lessen the capital of the company, thus depriving the State of the security it exacted that the railroad would be built, and diminishing the means intended for the protection of creditors, are therefore a fraud upon the grantor of the franchise, and upon those who may become creditors of the corporation. They are also a fraud upon unconditional stockholders, who subscribed to the stock in the faith that capital sufficient would be obtained to complete the projected work, and who may be compelled to pay their subscriptions, though the enterprise has failed, and their whole investment has been lost. It is for these reasons that such conditions are denied any effect."[1]

§ 1311. Parol Conditions Void. — Another principle is that *parol conditions*, varying the terms of the written subscription and not involving a fraud on the subscriber, are void, and the subscription stands as made,[2] — such, for instance, as the

[1] Burke *v.* Smith, 16 Wall. (U. S.) 390, 396. The principle was held inapplicable to the case in judgment. See *post*, § 1319.

[2] Cunningham *v.* Edgefield &c. R. Co., 2 Head (Tenn.), 23; Connecticut &c. R. Co. *v.* Bailey, 24 Vt. 465; *s. c.* 58 Am. Dec. 181; North Carolina R. Co. *v.* Leach, 4 Jones L. (N. C.) 340; Mississippi &c. R. Co. *v.* Cross, 20 Ark. 443; Evansville &c. R. Co. *v.* Posey, 12 Ind. 363; New Albany R. Co. *v.* Fields, 10 Ind. 187; Eakright *v.* Logansport &c. R. Co., 13 Ind. 404; Clem *v.* Newcastle &c. R. Co., 9 Ind. 488; *s. c.* 68 Am. Dec. 653; Carlisle *v.* Evansville &c. R. Co., 13 Ind. 477; Smith *v.* Tallahassee &c. R. Co., 30

condition that the payment should be made in *land* instead of money;[1] or that the subscriber is *not to pay* for the stock, but that his subscription is to be cancelled;[2] or that it is not to become obligatory unless the railroad intended to be built by the corporation is located on a certain *route*,[3] or completed to a certain *point*;[4] or fixing a *time for payment* variant from that fixed by the charter.[5] Nor is it a defense to an action for calls that the subscription was procured on the faith of another person taking stock in the company, unless such subscription was *fraudulently* procured, and the subscriber has not failed promptly to repudiate the fraud upon discovery of it.[6] The foregoing rule is founded on the principle which forbids the admission of parol evidence to vary or contradict written contracts.[7] It rests on the stronger ground that such conditions are

Ala. 650; Kennebec &c. Co. *v.* Waters, 34 Me. 369; Piscataqua Ferry Co. *v.* Jones, 39 N. H. 491; Thigpen *v.* Mississippi Central R. Co., 32 Miss. 347; Dill *v.* Wabash &c. R. Co., 21 Ill. 91; Blodgett *v.* Morrill, 20 Vt. 509; Minneapolis Threshing Machine Co. *v.* Davis, 40 Minn. 110; *s. c.* 12 Am. St. Rep. 701; 41 N. W. Rep. 1026; Bullock *v.* Falmouth &c. Turnpike Co., 85 Ky. 184; Scarlett *v.* Academy of Music, 46 Md. 132; Topeka Man. Co. *v.* Hale, 39 Kan. 23.

1 Baile *v.* Calvert &c. Education Soc., 47 Md. 117.

2 Robinson *v.* Pittsburgh &c. R. Co., 32 Pa. St. 334; *s. c.* 72 Am. Dec. 792; Greenville &c. R. Co. *v.* Coleman, 5 Rich. L. (S. C.) 118.

3 Callanan *v.* Judd, 23 Wis. 353: North Carolina &c. R. Co. *v.* Leach, 4 Jones L. (N. C.) 340; Rices *v.* Plank Road Co., 30 Ala. 92.

4 Madison &c. R. Co. *v.* Stevens, 6 Ind. 379. In such a case it was said: "The subscribers might have annexed a condition to the terms of their subscription, if they had thought proper to do so, and it would then have been with the commissioners to determine whether such conditional subscriptions of stock would be received; but, not having done so, they can not, according to the well established doctrine on the subject, allege or prove that the contract was different from that which is evidenced by the writing, unless they can establish fraud or mistake in its execution." Wight *v.* Shelby R. Co. 16 B. Monr. (Ky.) 4; *s. c.* 63 Am. Dec. 522. A railroad company cannot be *enjoined* from collecting installments on subscriptions for stock, because the money may be expended in extending the road beyond the county in which the stockholders reside, unless the contract of subscription expressly stipulated that the money should be expended in such county. Dill *v.* Wabash &c. R. Co., 21 Ill. 91.

5 Thigpen *v.* Mississippi Central R. Co., 32 Miss. 347.

6 Cunningham *v.* Edgefield &c. R. Co., 2 Head (Tenn.), 23.

7 Cunningham *v.* Edgefield &c. R. Co., 2 Head (Tenn.), 23; Scarlett *v.* Academy of Music, 46 Md. 132; Marshall Foundry Co. *v.* Killian, 99 N. C. 501; *s. c.* 6 Am. St. Rep. 539, 545; Bank *v.* Littlejohn, 1 Dev. & B. (N. C.) 563; Railroad Co. *v.* Leach, 4 Jones L. (N.

in the nature of *secret agreements* with particular subscribers which are a *fraud* upon other subscribers and sometimes upon the public.[1] Upon this ground all secret agreements made with particular subscribers at the time of their subscription are discharged by the law, and, in an action to enforce the contract of subscription, evidence of such agreements is not admissible.[2] But where the *promoters* enter into a secret agreement with a person to induce him to subscribe, it may be valid and enforcible *as against them*, though invalid as against the corporation.[3] Where such promises are made by *agents* of the corporation appointed to solicit stock subscriptions, and are contrary to the charter or governing statute, the courts have also held them void for *want of power in such agents* to make them.[4] An *exception* to this principle is that parol representations and agreements, made to induce a person to subscribe, may operate as a *fraud* upon him, so as to enable him to avoid his subscription, on principles discussed in a future chapter.[5]

§ 1312. Parol Agreements among Subscribers.— Neither is parol evidence of agreements with *previous subscribers* to the capital stock, made at or before their signing, and inconsistent with the written terms of their subscription, admissible in an

C.) 340. See article upon the subject by Hon. J. O. Pierce, 28 Am. L. Reg. (N. S.) 306.

[1] Downey *v.* White, 12 Wis. 176; *s. c.* 78 Am. Dec. 731; Foy *v.* Blackstone, 31 Ill. 538; *s. c.* 83 Am. Dec. 246. Thus, if the promoter of a corporation makes a secret agreement with a subscriber to repurchase the stock subscribed, this is a fraud on other subscribers ignorant of it, and the courts will not enforce it. Meyer *v.* Blair, 19 Abb. N. Cas. (N. Y.) 214.

[2] Phœnix Warehousing Co. *v.* Badger, 6 Hun (N. Y.), 293; Minneapolis Threshing-Machine Co. *v.* Davis, 40 Minn. 110; *s. c.* 12 Am. St. Rep. 701; 41 N. W. Rep. 1026; 3 L. R. A. 796; 26 Am. & Eng. Corp. Cas. 61.

[3] Thus, where the promoters of a corporation agreed with a person in writing, for the purpose of inducing him to subscribe to the stock of the company, to purchase the same of him at the end of a year, it was held that the agreement was not contrary to public policy in such a sense as not to be enforcible against them, although other subscribers had no notice of it. Morgan *v.* Struthers, 131 U. S. 246; *s. c.* 9 Sup. Ct. Rep. 726. To the same effect, see Meyer *v.* Blair, 109 N. Y. 600; *s. c.* 4 Am. St. Rep. 500.

[4] Thigpen *v.* Mississippi Central R. Co., 32 Miss. 347; *Ante*, § 1309.

[5] *Post*, § 1360 *et seq.* Scarlett *v.* Academy of Music, 46 Md. 132.

action for assessments.[1] One reason assigned for this is, that each subscription to the stock of a corporation is an independent contract, and in no way connected with or dependent upon the terms of agreement of other subscribers; in other words, that it is not a contract among the subscribers, but a contract between each subscriber and the corporation; and it has been held that this is so, although the subscription was taken before the corporation was organized, but subject of course to acceptance or rejection by the coporation when organized.[2] It is believed, however, that, whether the contract of subscription is to be regarded as a contract between each subscriber and the corporation, or a contract among the co-adventurers themselves, depends upon the language in which it is framed and other circumstances.[3] Another court has reasoned that the persons who subscribe to the capital stock and participate in the organization of a business corporation, under the guise of the authority conferred by statute, become a corporation *de facto*, if not *de jure*; and, having held out inducements to the public to deal with and credit it upon the faith of its chartered capital, they become liable, at least to the extent of the capital stock subscribed by them, and they cannot evade that liability by any private or secret arrangement that may have been entered into among themselves, or by a simulated payment of the stock subscribed; and if not actually paid, it may be reached by a creditor of the corporation, if it should become necessary.[4]

§ 1313. Subscriptions Made for Collateral Purposes. — In an English case decided upon like grounds, it appeared that, in order to obtain the passage of an act of Parliament inaugurating a stock company, it was necessary to show to the House of Lords that three-fourths of the shares had been subscribed; and that certain persons accordingly subscribed for shares in order to make up the deficiency, upon an agreement that they should

[1] White Hall &c. R. Co. *v.* Meyers, 16 Abb. Pr. (N. S.) (N. Y.) 34; La Grange &c. Plank Road Co. *v.* Mays, 29 Mo. 64.

[2] Connecticut &c. R. Co. *v.* Bailey, 24 Vt. 465; *s. c.* 58 Am. Dec. 181.

[3] *Ante*, § 1205.

[4] Marshall Foundry Co. *v.* Killian, 99 N. C. 501; *s. c.* 6 Am. St. Rep. 539, 546; *post*, § 1550.

be *held in trust for the company.* Suit having been brought by the directors for a call made upon one of these shares, Vice-Chancellor Shadwell was asked to enjoin the action, on the ground that the subscription was a mere fraud upon the legislature. But he treated the subscription as valid, and subsequent proceedings, whereby it was attempted to avoid it, were held void.[1] So it has been correctly held that a subscriber cannot plead, when sought to be charged by creditors of the corporation, that he became such at the request of an agent of the company, merely *as an inducement to others to subscribe.* Such a proceeding is alike condemned by law and good morals.[2] And where, at the time of the subscription, an agreement was entered into to the effect that the subscriber might *afterwards be released* as to a portion of his shares, it was held that, although as between the parties themselves both instruments would be construed together as parts of a single contract, yet, in favor of innocent persons deceived by the fraud, the subscription would be held good and the agreement of release void.[3] "In the subscription of each person," said the court, "every other subscriber has a direct interest. Their respective subscriptions are contributions or advancements for a common object. The action of each in his subscription may be supposed to be influenced by that of the others, and every subscription to be based upon the ground that the others are what upon their face they purport to be." [4]

§ **1314. Illustrations of Such Subscriptions.** — So, the manager of a banking company, in which he held shares, induced a friend, D., living in the country, to subscribe the company's deed for one hundred shares, upon the understanding, of which a minute was entered in the company's books, that all the shares that should not be transferred by him to other parties should be transferred for him by the directors, and that he should receive nothing nor incur any liability in respect of the

[1] Mangles *v.* Grand Collier Dock Co., 10 Sim. 519. And see Preston *v.* Grand Collier Dock Co., 2 Rail. C. 335.

[2] Pickering *v.* Templeton, 2 Mo. App. 425; Downie *v.* White, 12 Wis. 176; *s. c.* 78 Am. Dec. 731; White Mountains R. Co. *v.* Eastman, 34 N. H. 124; Blodgett *v.* Morrill, 20 Vt. 509; Davidson's case, 3 De G. & S. 21; Bridger's case, L. R. 9 Eq. 74; Litchfield Bank *v.* Church, 29 Conn. 137.

[3] White Mountains R. Co. *v.* Eastman, 34 N. H. 124, 140.

[4] White Mountains R. Co. *v.* Eastman, 34 N. H. 141, per Sawyer, J.

shares. After disposing of thirty shares, the purchase-money for which was paid to the directors, D., in pursuance of the arrangement, transferred the remainder back to the manager, by assigning them to him and his successors in office. He never received or paid anything in respect of the shares; and, eight years after the last transaction, the affairs of the company were wound up under the Joint-stock Companies Winding-up Act, 1848. It was held by Vice-Chancellor Shadwell that the effect of the transaction was to hold out D. as a partner, to induce others to become members of the company, and that he was properly placed on the list as a contributory.[1] - - - - And in another case, B., the local agent of an insurance company, being requested by the manager to take shares in order to induce other persons to become shareholders, offered to apply for one hundred shares on condition that he should not be called upon to pay anything for the shares, but that all payments on the shares should be deducted out of his commission on shares sold by him; and upon being told by the manager of the company that he would "be allowed the privilege of paying them up as convenient," he sent in a formal application for one hundred shares, which were duly allotted to him, and he was informed of the allotment, and he was registered as the holder of the shares; but he never paid any money on application or allotment, or any calls. The vice-chancellor held that the deliberate representation to others that he was a shareholder, when, according to his own view, he was not really a shareholder, for the purpose of inducing them to take shares, was a false representation, according to his own statement of his case, which, as between himself and the other shareholders, precluded him from the right to deny that he was what he represented himself to be.[2]

§ 1315. Contemporaneous Parol Declarations.— Upon like grounds, *parol declarations of officers of a company*, made on public occasions, if admissible at all to invalidate a stock subscription, cannot avail a subscriber who does not show that such declarations amounted to *fraud* on the part of the company, inducing error on his part when he subscribed.[3]

[1] Davidson's Case, 3 De G. & S. 21.

[2] Bridger's Case, L. R. 9 Eq. 74.

[3] Vicksburg &c. R. Co. *v.* McKean, 12 La. An. 638; Martin *v.* Pensacola R. Co., 8 Fla. 370; *s. c.* 73 Am. Dec. 713. Compare Mississippi &c. R. Co. *v.* Cross, 20 Ark. 443; Cunningham *v.* Edgefield &c. R. Co., 2 Head (Tenn.), 23. Especially where it is not shown that such declarations influenced the subscriber in making his subscription. Smith *v.* Tallahassee Branch &c. Co., 30 Ala. 650.

§ 1316. Collateral Agreements with Third Persons.— For stronger reasons, collateral agreements with *third persons* whereby the subscriber is induced to become such,— as an agreement to take his shares off his hands,— will not afford ground of releasing him from his liability as a stockholder,[1] — though evidence of such agreement may be admissible in an action for assessments, for the purpose of showing *fraud*.[2]

§ 1317. View that Conditions in Subscriptions not Contrary to Public Policy.— It is difficult to support the view taken by some of the courts,[3] that subscriptions to the capital stock of corporations, organized to promote works of public utility, are contrary to public policy, when made to depend upon the compliance with some condition,— such as the location of the proposed road on a particular route, or extending it to a particular place. This view has been rejected in other States,[4] and the better view adopted in its stead that conditional subscriptions may be received by a company when not forbidden by the charter, and that on the performance of the conditions, they become absolute.[5]

§ 1318. Illustrations of Good Conditional Subscriptions.— In addition to the other illustrations given in this chapter, we find that subscriptions to the stock of plank road companies,[6] and railroad companies,[7] have been upheld where they have been made on condition of the road being located on a certain route. - - - - So, a subscription for stock in a railroad, made upon condition that it shall not be payable until needed for the construction of a certain portion of the

[1] Stutz *v.* Handley, 41 Fed. Rep. 531.

[2] Danbury &c. R. Co. *v.* Wilson, 22 Conn. 435.

[3] *Ante*, § 1309.

[4] McMillan *v.* Maysville &c. R. Co., 15 B. Monr. (Ky.) 235; *s. c.* 61 Am. Dec. 181; Henderson &c. R. Co. *v.* Leavell, 16 B. Monr. (Ky.) 364; Taggart *v.* Western Maryland R. Co., 24 Md. 563; *s. c.* 89 Am. Dec. 760, 770; New Albany &c. R. Co. *v.* McCormick, 10 Ind. 499; *s. c.* 71 Am. Dec. 337; Keller *v.* Johnson, 11 Ind. 337; *s. c.* 71 Am. Dec. 355; Branham *v.* Record, 42 Ind. 181, 199; Jacks *v.* Helena, 41 Ark. 213; Coyote Gold &c. Co. *v.* Ruble, 8 Or. 284.

[5] Chamberlain *v.* Painesville &c. R. Co., 15 Ohio St. 225; Ashtabula &c. R. Co. *v.* Smith, 15 Ohio St. 328; Franklin College *v.* Hurlburt, 28 Ind. 344; Topeka &c. Co. *v.* Cummings, 3 Kan. 55. Compare Pittsburgh &c. R. Co. *v.* Plummer, 37 Pa. St. 413.

[6] Rhey *v.* Ebensburg &c. Plank Road Co., 27 Pa. St. 261.

[7] See *ante*, § 1285 *et seq.*

road, and that the amount paid shall be applied solely to such construction, has been held not void as against public policy.[1] - - - - In another case a form was prescribed by the charter of a railroad company in which subscriptions to stock should be taken, and it was further provided that the company should have all the powers incident to a corporation at common law. A subscription followed the language of the form, and contained additional stipulations, not inconsistent with those prescribed by the form, which would have been competent at common law for the parties to make. The subscription was held valid.[2] - - - - In a doubtful case in Kansas it appeared that H. delivered to a corporation $200, and took the following writing signed by the agent and the president thereof: "H. has paid into the grange agency $200 to be used as conditional stock, with the agreement by the directors of the association that while it is used it shall have the same advantages as other stock, but that H. can draw out said money at any time by giving 30 days' notice to the agent, in writing." The court held that, on such notice, H. was entitled to a return of the money loaned. The expression "the same advantages," did not make the money regular capital stock.[3] - - - - In a Federal court case the president of a locomotive manufacturing company subscribed to the stock of a railroad company. The subscription was for seventy shares "payable in cash, on the delivery of the last engine of twelve from the locomotive manufactory." In an action for the amount of the subscription it was held competent for the defendant to put in evidence a contract made with his company, on the same day with the subscription, for the delivery of twelve engines to the plaintiff, and to show by parol that that was the contract referred to in the subscription, and that all the engines had not been delivered.[4]

§ 1319. Other American Cases where Conditional Subscriptions have been Upheld. — A. subscribed a given amount to the capital stock of a railway company upon the expressed condition that if B., a municipal corporation of which he was a citizen and taxpayer, should subscribe a given amount to the capital stock, A. might transfer all of his shares above a given amount to B., in satisfaction of his subscription. B. subscribed the given amount, and the transfer of shares from A. to B. was afterwards made. It was held that A. was not liable to creditors in respect of the shares so transferred. The transaction being a fair one, the fact that A. was a director of the cor-

[1] Milwaukee &c. R. Co. *v.* Field, 12 Wis. 340.

[2] Fisher *v.* Evansville &c. R. Co., 7 Ind. 407.

[3] Hinton *v.* Morris Co-operative Society, 21 Kan. 663.

[4] Rutland &c. R. Co. *v.* Broker, 4 Blatchf. (U. S.) 179.

poration did not alter the case.[1] - - - - A conditional agreement to take shares has been upheld when made before the fact of incorporation, when entered into between the subscriber and a person getting up the corporation; such as in England would be called a "promoter" of the corporation; the reason being that given by Lord Cottenham,[2] that an incorporated company will be bound by the agreement of its individual members, acting before incorporation on its behalf, if the company has received the full benefit of the consideration for which the agreement stipulated in its behalf. But the case in which this ruling was made, though perhaps correctly decided on its peculiar facts, contains argument that is manifestly contrary to sound principles.[3]

§ 1320. Illustrative English Cases.— Before the existence of the Joint-stock Companies Act of 1844,[4] the English courts went far in

[1] Burke *v.* Smith, 16 Wall. (U. S.) 390. See New Albany *v.* Burke, 11 Wall. (U. S.) 90, 96; *ante*, § 1310.

[2] Edwards *v.* Grand Junction R. Co., 1 Myl. & Cr. 650, affirming the decision of Vice-Chancellor Shadwell, in the same case, 7 Sim. 337.

[3] Burrows *v.* Smith, 10 N. Y. 550. In this case articles of association had been prepared with the view of organizing a banking company under the general banking law of New York. In these articles commissioners were named to obtain subscriptions to the capital stock. These commissioners obtained certain subscriptions, payable in bonds secured by mortgages upon the farms of the subscribers, upon the faith of a promise that the bank, when organized, would advance the necessary money to pay off the prior incumbrances upon their lands, so that their bonds and mortgages might be accepted in payment of stock. The persons named subscribed regularly to the certificate of incorporation, the number of shares taken by each being affixed to his name. The bank never advanced the money to these subscribers to pay off the prior mortgages on their farms, according to the condition of their subscription; but the bank did business for about four years, declaring and paying dividends to its shareholders, but not paying any to these subscribers, who appear not to have been recognized as such. Meantime the bonds and mortgages given by them in payment of their stock were held first by the promoter of the bank, who had received them, then by an agent of the comptroller of the State, and then by the bank. The bank becoming insolvent, they passed into the hands of a receiver, who brought suit on them. It appeared that all the creditors of the bank had been satisfied. The only questions arising related, therefore, to the rights of the shareholders *inter sese*. It was held that, the bank having failed to perform the condition on which the subscription was made, there was no contract. The other shareholders, whose rights alone were concerned, were bound by the conduct of the corporation in its refusal to recognize these subscribers as shareholders. The doubt about the case consists in the fact that the subscription, on its face, was absolute and regular, and that the condition for the non-performance of which it was discharged was a mere parol agreement without doubt unlawful. See *ante*, § 1308.

[4] 7 & 8 Vict. c. 110.

releasing persons who had agreed to take shares on the faith of certain representations as to the capital of the company, which representations were not fulfilled, in cases where it did not appear that creditors had given credit on the faith of such subscribers being members. Thus, in one case the prospectus of a company stated that the capital would be 10,000 shares of £25 each. Only 1,400 of the shares were taken. The directors commenced operations on this capital. The defendant had previously applied for shares, and paid the deposit thereon. After building operations commenced, a call was made, which the defendant paid. On the trial of this case the jury were instructed that, without evidence that the defendant knew and assented to the works being carried on with a smaller capital than that which was originally proposed, he would not be bound by the contract of the directors. This ruling was sustained on appeal, Alderson, B., saying: "The authority given by the subscribers to the directors is a conditional one, depending on the terms of the prospectus being fulfilled. In this case that condition had not been fulfilled, and therefore, the defendant is not bound by the contract of the directors."[1] - - - - But an allottee who had paid his deposit on shares in a company which was afterwards completely registered under the above act, was not, under the Joint-stock Companies Winding-up Act, 1848, entitled to be excluded from the list of contributories, on the ground that a condition expressed on the scrip certificate, that the capital would be £10,000 in 4,000 shares, had not been fulfilled, and that 2,600 shares only had been subscribed for.[2] - - - - But where a person being applied to to become a member of a committee of a provisionally registered railway company, consented by a letter, with a postscript to the effect that the acceptance should be taken subject to his approval of the plans, and that he should be held free from all liability, and he afterwards attended a meeting at which the managing committee was appointed, it was held that the qualification contained in the postscript was an integral part of the acceptance, and that he was not liable to be put on the list of contributories.[3] - - - - Where a person applied in writing for shares in a joint-stock company, but on the expressed condition that he should have the supplying of certain articles required by the company, and the shares were allotted to him, but the company never came to a definite arrangement as to the supplying of the articles, and he never paid a deposit, signed articles, nor did any act

[1] Pitchford *v.* Davis, 5 Mee. & W. 2. See *ante*, § 1236.

[2] Sharpus' Case, 3 De G. & S. 49; Earl of Mansfield's Case, 3 De G. & S. 58.

[3] Robert's Case, 3 De G. & S. 205; affirmed on appeal, 2 Mac. & G. 192.

amounting to an unqualified acceptance of the shares, it was held that he could not be made a contributory.[1]

§ 1321. Distinction in Respect of Conditional Subscriptions Made before and after Organization. — In Pennsylvania, this distinction has been taken: that subscriptions made before the corporation is organized must be unconditional, while those made afterwards may be conditional.[2]

§ 1322. Condition that All the Stock shall be Subscribed. — As a general rule, where, on the organization of a corporation, the number of shares of the capital stock and the sum to be paid for each share are agreed upon and inserted in the agreement of subscription, the subscribers are not bound to pay their subscriptions until the requisite number of shares is filled up by subscriptions.[3] The same rule applies where the company is incorporated under a general law which requires that the amount of its stock and the number and denomination of its shares shall be stated in a recorded certificate. Here no valid assessments can be made on subscribers until the whole capital stock is taken, unless there be a provision to that effect, either in the recorded certificate or in the general law under which the company is incorporated; and in such a case the subscription may be considered to that extent conditional.[4] This rule, stated in more general terms, is that where a corporation is formed, or attempted to be formed, under general statutes, the inchoate proceedings do not ripen into a corporation until all the requirements of the statute, even the filing of the articles in the office of the secretary of State, are complied with. Until this is done, a subscription to the articles is a mere proposition to take the number of shares specified of the capital stock of the company thereafter to be formed, and is not a binding promise to pay. The obligation is inchoate merely, and can

[1] Wood's Case, 3 De G. & J. 85.

[2] Pittsburgh &c. R. Co. *v.* Stewart, 41 Pa. St. 54, 58; Caley *v.* Philadelphia &c. R. Co., 80 Pa. St. 363; *ante*, § 1308.

[3] Cabot & West Springfield Bridge *v.* Chapin, 6 Cush. (Mass.) 50. Compare Franklin Ins. Co. *v.* Hart, 31 Md. 59; Crocker *v.* Crane, 21 Wend. (N. Y.) 218; *s. c.* 34 Am. Dec. 228. See *ante*, §§ 1235, 1306, 1320. This rule, as we shall see (*post*, § 2103) does not apply to the case of a company issuing *additional shares.*

[4] Hager *v.* Cleveland, 36 Md. 476. Compare Hughes *v.* Antietam Co., 34 Md. 316.

never become of force unless the corporation goes into effect in the mode pointed out by the statute.[1] This rule and the reason on which it rests are stronger where a subscription to the capital stock of a corporation is made upon condition that the company shall not be organized, or shall not enter upon the principal object of its organization, until a given amount of its stock shall be subscribed. Such condition is a condition precedent, and the company will not be authorized to enforce the collection of such subscription until the conditions are complied with on its part.[2] But where the charter of a railroad corporation provided that the construction of the railway should not be begun until three-fourths of the estimated cost were subscribed for by responsible persons, — it was held, that the corporation would not be obliged to show a compliance with this provision in order to maintain an action against a subscriber for an assessment upon the stock.[3] Where the terms of the subscription required that seventy-five *per centum* of the estimated cost of any sections of the railroad should be subscribed for by responsible persons before commencing its construction, it was held that, if the subscription was obtained in good faith, assessments would be valid, although some of the subscriptions to make up that amount should turn out to be *worthless*.[4] It is obvious that there may be conditions precedent to the right of the corporation to recover upon a stock subscription, which will not be regarded as conditions precedent to the right of the corporation to organize and enter upon the enjoyment of its franchises. Of this character it was held was a provision in the charter of a railroad company, requiring a certain amount of stock per mile to be subscribed before the company went into operation.[5]

§ 1323. Waiver of this Condition. — In either case, however, the subscribers may *waive* the condition, and, with their

[1] Burt *v.* Farrar, 24 Barb. (N. Y.) 518; 1 Redf. Rail., § 18, note 2.

[2] Penobscot &c. R. Co. *v.* Dunn, 39 Me. 587. See Penobscot &c. R. Co. *v.* Dummer, 40 Me. 172; *s. c.* 63 Am. Dec. 654; Phila. &c. R. Co. *v.* Hickman, 28 Pa. St. 418; Ridgefield &c. R. Co. *v.* Brush, 43 Conn. 86.

[3] Penobscot R. Co. *v.* White, 41 Me. 512; *s. c.* 66 Am. Dec. 257.

[4] Penobscot &c. R. Co. *v.* Dummer, 40 Me. 172; *s. c.* 63 Am. Dec. 654.

[5] Swartwout *v.* Michigan &c. R. Co., 24 Mich. 389. But see Mitchell *v.* Rome &c. R. Co., 17 Ga., 574; Wood *v.* Coosa &c. R. Co., 32 Ga. 273, 291.

assent, the company may not only organize, but do all other things incident to and necessary for the prosecution of the particular business for which it was incorporated, just as they may waive other conditions upon which their subscriptions may have been made.[1] This waiver may be either *express*, or *implied* from the acts and declarations of the subscribers. If, knowing that the whole capital stock has not been taken, they attend meetings of the company, co-operate in the votes for the expenditure of money for the purchase of property, for the making of contracts, and for other acts which could only be properly done upon the assumption that the subscribers intended to proceed with the stock partially paid up, they will be estopped from setting up such a defense.[2]

§ **1324. Impossible Conditions.** — It has been held that a condition in the stock subscription, providing for its forfeiture, upon giving notice of an intention to forfeit at or before a date which is prior to the date of the subscription, is a nullity, such notice being impossible, and that the subscription is binding.[3]

§ **1325. Conditions as to Assessability of Shares.** — The validity of conditions as to the time and manner of assessing the shareholders depends, of course, upon the language of the charter or governing statute.[4] If a subscription is made upon a condition in this respect which the officers of the corporation have no power to concede to subscribers, then on sound principles, it should be held that *there is no contract* which will enable the corporation to make and enforce the assessments at any

[1] *Post*, § 1336

[2] Hager *v.* Cleveland, 36 Md. 476.

[3] Racine &c. Bank *v.* Ayers, 12 Wis. 512.

[4] Where a railroad company was authorized to collect installments of stock at such times as might be required by its president and directors, and the defendant subscribed for shares in the company, payable when needed for the payment of the contractors for the construction of the road, in such installments as should be called and required by the president and directors of the company from time to time, the amount to be expended upon the road in Itawamba county, it was held that the president and directors had no right to call for the payment of such installments, until it became requisite to pay contractors for the construction of the road at the point stated. Roberts *v.* Mobile &c. R. Co., 32 Miss. 373. See *post*, § 1351.

other time or in any other manner.[1] The mere *mode* of making the assessment may, in the event of the insolvency of the company, be discharged as not of the essence of the contract, and instead of the assessment being made by the directors, a court of equity may make it, and enforce the collection of it through its receiver for the benefit of the creditors of the corporation. This doctrine clearly applies where, by the terms of the contract, the subscriptions are made payable *upon the call of the company*. The company becoming insolvent, a *court of equity* will step in and enforce the payment of the amount subscribed, although no call has been made.[2] This doctrine was applied in a case where the contract of subscription and the stock certificate expressed the condition that a balance of eighty per cent. unpaid on the stock was to be paid on the call of the directors, *when ordered by a vote of a majority of the stockholders themselves*. With such contracts of subscription subsisting, most of the balance of eighty per cent. not having been called in, the company became bankrupt, and its assignee in bankruptcy proceeded against its shareholders to enforce calls made by the court of bankruptcy. The stockholders claimed that they could not be made liable in any other way than by a call ordered by a majority of themselves, as provided in the subscription contract; that the authority to assess could not be delegated so as to be effectually exercised by the court, or by any one else; that there was no power vested in any court, or body of men, or directors, to assess the stockholders, unless they directed or consented to it themselves. "This," said Hopkins, J., "presents certainly a novel question, being nothing more nor less than a claim that a party may legally and morally owe a debt, and yet frame a contract so that its payment shall be wholly discretionary, and not subject to be enforced in the courts without his consent. It is not necessary to decide whether a provision of that kind would not be contrary to the principles of remedial justice as between the parties themselves, and therefore void; but whether so or not, the attempt to set up such a defense as against the creditors of the company, who have entered into contracts with it without knowledge of any such

[1] *Ante*, § 1308.

[2] Curry *v.* Woodward, 53 Ala. 373. *Post*, § 1332.

stipulation, and whose only means of obtaining payment is by compelling stockholders to pay the balance due upon their stock, is without a parallel in judicial proceedings. Such a scheme I do not think ever has or ever can receive the sanction of the legislature or of the courts." The defense was accordingly disallowed.[1]

§ 1326. Stipulation for the Payment of Interest on Stock Subscription. — It has been held that a stipulation for the payment of *interest* on the amount paid in on a stock subscription in a railroad company, until the declaration of a dividend, does not invalidate the subscription.[2] In another case the charter of a railroad corporation provided that a certain amount of capital stock should be subscribed, before any assessments should be made. The number of shares requisite to make up such amount was subscribed, but the subscription contained a condition that *interest* should be paid by the corporation on all sums assessed and paid in, from the time of payment until the railroad should be put in operation. It was held that such condition did not avoid the subscription.[3]

§ 1327. Validity of Conditions as Affected by the Statute of Frauds. — Where the attempt is made to avoid the contract of subscription under the statute of frauds, on the ground that it is based upon a condition not to be performed within one year, the principle will apply which takes the case out of the statute where the agreement is *capable* of being performed within one year; nor will the subscriber be allowed to set up this defense where the condition *has been* performed, although not within one year.[4]

[1] Upton *v.* Hansbrough, 3 Biss. (U. S.) 117, 126.

[2] Racine &c. Bank *v.* Ayers, 12 Wis. 512.

[3] Rutland &c. R. Co. *v.* Thrall, 35 Vt. 536.

[4] Thus, in an action upon a subscription paper, the complaint set out the contract, which was as follows: "Ten days after the completion of the I. & St. L. Railroad from Indianapolis to the west line of Hendricks county, and the running of a train of cars thereon, I promise to pay to the order of said railroad company, at the First National Bank of Danville, Ind., the sum of one hundred dollars, without any relief whatever from valuation of appraisement laws. The consideration of this note is the construction of

§ 1328. What Amounts to an Acceptance by the Corporation of a Subscription upon Condition.— Unless the corporation proposes, by a prospectus, by the form of contract which it tenders to subscribers, or otherwise, that the subscription shall be on a certain condition, then a subscription with that condition annexed to it is a mere *proposal* for a contract, made by the intending subscriber to the corporation, and must be accepted by the latter in order to make it a contract.[1] Such an acceptance must, on principle, be the act of the board of directors of the corporation, either by the grant of precedent authority to the agent sent out to procure the subscription, or by a resolution passed when acting as a board,— or at least by their affirmative corporate action showing their concurrence in the proposal.[2] It has been held that their acceptance of such a subscription by an entry on the records of the corporation, without communicating the fact of the acceptance to the subscriber, is sufficient.[3] But this holding is contrary to principle,— the rule being that a proposal for a contract does not become a contract until an acceptance of it is affirmatively indicated to the proposer in some way, as by depositing a letter of acceptance in the mails,[4] or by forwarding the goods requested, or the like. On a principle hereafter more fully explained,[5] the consent of several members of the board of directors, acting separately and not as a board, and not shown to constitute a quorum, will not constitute an acceptance of such proposal.[6] But such an acceptance may be

said road as aforesaid, within one half mile of the town of Danville, and the promise and agreement of said company that, by means of said road and its connections, the company will run trains through from Indianapolis to East St. Louis within two years from the first day of January, 1869;" dated November 25th, 1868, and signed by the defendant: — and averring performance within the time and in the manner mentioned. It was held: 1. That the contract, being capable of performance within one year, was not within the statute of frauds. 2. That if the contract had originally been within the statute, and therefore not binding on the plaintiff, yet after the performance by the company, the maker could not defend on the ground that he alone had signed the instrument. Straughan *v.* Indianapolis &c. R. Co., 38 Ind. 185.

[1] Junction R. Co. *v.* Reeve, 15 Ind. 236.

[2] *Ibid.*

[3] New Albany R. Co. *v.* McCormick, 10 Ind. 499; *s. c.* 71 Am. Dec. 337.

[4] *Ante*, § 1178, 32 Am. Rep., p. 40, note; Maclay *v.* Harvey, 90 Ill. 525; *s. c.* 32 Am. Dec. 35.

[5] *Post*, § 3905, *et seq.*

[6] Junction R. Co. *v.* Reeve, 15 Ind. 236.

shown by acts as well as by writings; and the subsequent payment by the subscriber of a deposit of five per cent. required by the terms of the contract, and the acceptance by the company of this payment, are sufficient evidence of a concurrence of the minds of the contracting parties.[1]

Article II. Effect of Conditions in Subscriptions.

§ 1332. No Contract until Valid Conditions Complied with.—If the condition is *expressed* on the face of the subscription agreement, and is valid under rules and theories already discussed, the obligation of the subscriber does not become binding until the condition has been *performed* by the corporation, or *waived* by the subscriber: until that time he cannot be held to the liabilities of a shareholder.[2] It is scarcely necessary to suggest that the corporation cannot elect to treat as uncondi-

[1] Nicholas *v.* Burlington &c. Co., 4 Greene (Iowa), 42.

[2] Fort Miller &c. R. Co. *v.* Payne, 17 Barb. (N. Y.) 579; Chase *v.* Sycamore &c. R. Co., 38 Ill. 215; Wear *v.* Jacksonville &c. R. Co., 24 Ill. 593; Burke *v.* Smith, 16 Wall. (U. S.) 390; Pitchford *v.* Davis, 5 Mee. & W. 2; Fox *v.* Clifton, 6 Bing. 776; Robert's case, 3 De G. & S. 205; Wood's case, 3 De G. & J. 85; Buffalo &c. R. Co. *v.* Pottle, 23 Barb. 21; Macedon &c. Plank-road Co. *v.* Lapham, 18 Barb. 312; Burlington &c. R. Co. *v.* Boestler, 15 Iowa, 555; Henderson *v.* Railroad Co., 17 Texas, 573; Penobscot &c. R. Co. *v.* Dummer, 40 Me. 172; *s. c.* 63 Am. Dec. 654; Penobscot &c. R. Co. *v.* Dunn, 39 Me. 587; Philadelphia &c. R. Co. *v.* Hickman, 28 Pa. St. 318; Evansville &c. R. Co. *v.* Shearer, 10 Ind. 244; Jewett *v.* Lawrenceburg &c. R. Co., 10 Ind. 539; New Albany R. Co. *v.* McCormick, 10 Ind. 499; Junction R. Co. *v.* Reeve, 15 Ind. 236; Milwaukee

tional a subscription which has been made upon a valid and expressed condition.[1] The English courts accordingly hold that if the application for shares is conditional there is no contract, although the allotment is unconditional.[2] Nor is it necessary, within the meaning of this rule, that the expression of the condition should be in the same letter with the application for the shares, provided they reach the directors together.[3]

§ **1333. Subscribers' Right to Notice of the Performance of the Condition.** — The subscriber is entitled to *notice* of the performance of the condition before an action can be sustained against him on his contract,[4] unless the act be one that carries notice of itself.[5] He will, however, be affected by a *general notice* to stockholders.[6]

§ **1334. Illustrations of the Foregoing.** — Where the inhabitants of a township vote for a subscription to a railroad, on condition that the

R. Co. *v.* Field, 12 Wis. 340; Dayton &c. R. Co. *v.* Hatch, 1 Disney (Ohio), 84; Roberts *v.* Mobile &c. R. Co., 32 Miss. 373; Brand *v.* Lawrenceville Branch R. Co., 77 Ga. 506; Thrasher *v.* Pike &c. R. Co., 25 Ill. 393; Burrows *v.* Smith, 10 N. Y. 550; Charlotte &c. R. Co. *v.* Blackely, 3 Strobh. (S. C.) 245; Fremont Ferry &c Co. *v.* Fuhrman, 8 Neb. 99; Galt *v.* Swain, 9 Gratt. (Va.) 633; *s. c.* 60 Am. Dec. 311; Martin *v.* Pensacola R. Co., 8 Fla. 370; *s. c.* 73 Am. Dec. 714; Brookville &c. Turnp. Co. *v.* McCarty, 8 Ind. 392; *s. c.* 65 Am. Dec. 768; Norris *v.* Sweeney, 60 N. Y. 463; Ashtabula R. Co. *v.* Smith, 15 Oh. St. 328; Mansfield R. Co. *v.* Stout, 26 Oh. St. 241; McMillan *v.* Maysville &c. R. Co., 15 B. Monr. (Ky.) 218; Hunt *v.* Kansas Bridge Co., 11 Kan. 412; Ticonic Water Power Co. *v.* Lang, 63 Me. 480; Salem Mill Dam Corp. *v.* Ropes, 6 Pick. (Mass.) 23; People's Ferry Co. *v.* Balch, 8 Gray (Mass.), 303; Troy &c. R. Co. *v.* Newton, 8 Gray (Mass.), 596; Lail *v.* Mt. Sterling Co., 13 Bush (Ky.), 32; Hanover Junction R. Co. *v.* Haldeman, 82 Pa. St. 36. Compare Oldham &c. R. Co. *v.* Veazie, 39 Me. 571. Such subscriptions are not to be considered in determining whether sufficient stock has been subscribed to entitle the corporation to organize under its governing statute and articles of incorporation, without proof that the condition has been complied with. Oskaloosa Agricultural Works *v.* Parkhurst, 54 Iowa, 357.

[1] Brand *v.* Lawrenceville Branch R. Co., 77 Ga. 506.

[2] Shackleford's Case, L. R. 1 Ch. 567; Roger's Case, L. R. 3 Ch. 637.

[3] Roger's Case, L. R. 3 Ch. 637.

[4] Banet *v.* Alton &c. R. Co., 13 Ill. 504; Spangler *v.* Indiana &c. R. Co., 21 Ill. 276; Wear *v.* Jacksonville &c. R. Co., 24 Ill. 593; Chase *v.* Sycamore &c. R. Co., 38 Ill. 218.

[5] Chase *v.* Sycamore &c. R. Co., 38 Ill. 218.

[6] Nichols *v.* Burlington &c. Co., 4 Greene (Iowa), 42. See *post*, § 1339.

road shall be constructed and its station built within a mile of a certain town, it is no excuse for non-compliance by the company with such condition that its non-performance of it was "at the request and desire" of the inhabitants of the town; for the power of the voters of a township is purely statutory, and exhausts itself when such voters give expression at the polls to their assent to or dissent from the proposed subscription.[1] - - - - A. subscribed in aid of a railroad to be built. The company, in consideration of the subscriptions, agreed to deposit collaterals to secure them. After A. had paid some installments of his subscription, the company made such a disposition of the collaterals as to put them beyond the control of the subscribers in the manner originally contemplated. It was held that A. was released from his obligation.[2]

§ 1335. Subscription Becomes Absolute when Condition Performed. — Assuming again that the condition is valid under the rules and theories already discussed, it is to be added that it becomes absolute and binding upon the subscriber whenever it is *performed* by the corporation.[3] This must be especially true where the subscription is made *after the organization* of the corporation. In such a case it is supposed that the question of the *power* of the corporation to accept a subscription based upon the given condition, could have no influence on the question of the liability of the subscriber; since in general the doctrine of *ultra vires* can not be set up to defeat a contract after it has been *performed* by one of the parties to it. On this question the Court

[1] State ex rel. *v.* County Court, 64 Mo. 30.

[2] Reusens *v.* Mexican Nat. Construction Co., 22 Fed. Rep. 522.

[3] Franklin College *v.* Hurlburt, 28 Ind. 344; Topeka &c. Co. *v.* Cummings, 3 Kan. 55; St. Charles Manuf. Co. *v.* Britton, 2 Mo. App. 290; McGinnis *v.* Kortkamp, 24 Mo. App. 378; Taggart *v.* Western Maryland R. Co., 24 Md. 563; *s. c.* 89 Am. Dec. 760; Santa Cruz R. Co. *v.* Schwartz, 53 Cal. 106; Evansville &c. R. Co. *v.* Shearer, 10 Ind. 244; Jewett *v.* Lawrenceburg &c. R. Co., 10 Ind. 539; Junction R. Co. *v.* Reeve, 15 Ind. 236; Indianapolis &c. R. Co. *v.* Holmes, 101 Ind. 352; Merrill *v.* Gamble, 46 Ia. 615; Banet *v.* Alton &c. R. Co., 13 Ill. 504; Penobscot &c. R. Co. *v.* Dunn, 39 Me. 587; Central Turnp. Corp. *v.* Valentine, 10 Pick. (Mass.) 142; Swartwout *v.* Michigan &c. R. Co., 24 Mich. 389; Burrows *v.* Smith, 10 N. Y. 550; Dorris *v.* Sweeney, 60 N. Y. 463; Hamilton &c. Plank Road Co. *v.* Rice, 7 Barb. (N. Y.) 157; Chamberlain *v.* Painesville &c. R. Co., 15 Oh. St. 225; Ashtabula &c. R. Co. *v.* Smith, 15 Oh. St. 328; Spartanburg &c. R. Co. *v.* De Graffenreid, 12 Rich. L. (S. C.) 675; *s. c.* 78 Am. Dec. 476; Lowe *v.* Railroad Co., 1 Head (Tenn.), 659.

of Appeals of Maryland have observed: "If the corporation, after organization, may dispose of their stock without limitation, except so far as expressly restrained by their charter, and a conditional agreement when accepted is equivalent to an absolute contract, it would seem a necessary consequence that all contracts for stock in consideration of a particular location, when complied with by the company, would be as binding on both parties as if the contract had been absolute and unconditional. For, however adverse to public policy such conditions prior to the formation of the corporation, the location and construction of the road are the peculiar province and duty of the president and directors, and a contract made by them in execution of their corporate powers must be presumed to be made in promotion of the public interest, unless shown to the contrary."[1] On this theory it has been held that a subscription to the capital stock of a railroad company, the payment of which is made dependent upon completion of a part of its road, may be enforced when such conditions have been complied with, although at the time of the subscription the company was without corporate capacity to receive it, because it had not fulfilled the requirements of the statute by expending the necessary precentage of its authorized capital in the construction of its road, or obtained the necessary amount of subscriptions to its capital stock.[2]

§ **1336. Waiver of the Condition.** — Of course the subscriber may subsequently *waive* the condition and bind himself absolutely;[3] and it has been held that this is done by executing a *promissory note* for the amount for which he has subscribed;[4] or by delivering an absolute *deed in payment* where the subscription is payable in *land*.[5] So, it has been held that the giving by the subscriber of his promissory note for an unpaid balance of his subscription, and his taking therefor the company's receipt,

[1] Taggart *v.* Western Maryland R. Co., 24 Md. 563; *s. c.* 89 Am. Dec. 760, opinion by Bowie, C. J.

[2] Armstrong *v.* Karshner, 47 Oh. St. 276; *s. c.* 24 N. E. Rep. 897; 44 Am. & Eng. Corp. Cas. 238.

[3] Slipher *v.* Earhart, 83 Ind. 173; Evansville &c. R. R. Co. *v.* Dunn, 17 Ind. 603; Compare Henderson &c. R. Co. *v.* Mass, 2 Duv. (Ky.) 242.

[4] O'Donald *v.* Evansville &c. R. Co., 14 Ind. 259. Compare Miller *v.* White, 7 Blackf. (Ind.) 491.

[5] Parks *v.* Evansville &c. R. Co., 23 Ind. 567.

stipulating that, when paid, the amount of the note should be applied on his stock, is *prima facie*, a waiver of *conditions precedent*.[1] On the other hand, it has been held that the giving by the subscriber of his promissory note for his subscription does not waive a *condition subsequent* thereon, unless such was the *intention* of the parties, — the court saying: "No doubt, if it was the intention of the parties to waive the condition, effect should be given to such intention; but the facts as shown do not of themselves amount to such a waiver."[2] So, if *part* of a conditional subscription has become due by performance of the condition, a postponement of its payment is sufficient *consideration* for a note given by the subscriber by which he promises unconditionally to pay the whole at a future day, and at a time before the residue would have been due by the original terms of the subscription.[3]

§ 1337. **By Acting as a Stockholder.** — We have already seen[4] that, assuming the condition to be valid within the rules and theories already discussed, the subscriber is not a stockholder until the condition is complied with by the corporation. But suppose he *acts as a stockholder*, prior to that time: this will be a conclusive *waiver* of his right to insist upon the performance of the condition, on the principle of *estoppel*, hereafter discussed. Thus, although a subscription paper be expressed to be upon condition that a specific sum shall be raised, yet if a subscriber coöperates in prosecuting the enterprise and incurring liabilities with knowledge that the full amount has not been subscribed, this act operates as a waiver of the condition.[5] It was held that such a waiver had taken place where the subscriber paid the first installment due on his subscription, voted at a corporate election in right of all the shares for which he had subscribed, and acted

[1] Chamberlain *v.* Painesville &c. R. Co., 15 Oh. St. 225.

[2] Parker *v.* Thomas, 19 Ind. 213; *s. c.* 81 Am. Dec. 385, 391. Compare Keller *v.* Johnson, 11 Ind. 337; *s. c.* 71 Am. Dec. 355; Taylor *v.* Fletcher, 15 Ind. 80. The subject of the waiver by the subscriber of conditions precedent in his contract of subscription is discussed in 15 Am. & Eng. Corp. Cas. 535, n.

[3] Henderson &c. R. Co. *v.* Mass, 2 Duv. (Ky.) 242.

[4] *Ante*, § 1332.

[5] Hutchins *v.* Smith, 46 Barb. (N. Y.) 235; Reformed &c. Church *v.* Brown, 17 How. Pr. (N. Y.) 287.

as an officer of the company.[1] This effect has been ascribed to the act of the subscriber in serving as a director, where to his subscription were annexed the words, "To be expended between the Connecticut River and the east line of the State." [2] On this principle, where the defendants subscribed for *additional stock* in an iron company, and at a stockholders' meeting it was agreed that such additional subscription should not be called in until the furnace was put in blast; but subsequently the directors, by an agreement of the stockholders, among them the defendants, leased the furnace to B., who put it in blast; and the furnace was sold at sheriff's sale by creditors of the company, who brought suit against the defendants to recover their unpaid subscriptions, — it was held that, as the defendants agreed to the leasing of the furnace, they *waived* the condition upon which the subscriptions were to be paid, and were liable for the whole amount.[3]

§ **1338. Other Grounds of Estoppel.** — Other grounds of estoppel against the subscriber may be raised under the facts of particular cases. Where a commissioner, appointed to receive subscriptions to the stock of a railroad company, subscribed for shares in his own name, and united with the other commissioners in a certificate to the governor, on which letters-patent were issued, reciting that the subscriptions "were in all respects made and taken in good faith, and agreeably to the provisions and requirements of the acts of assembly, and the laws of the commonwealth," — it was held that he was *estopped*, in an action to recover such subscription, from showing that it was made on a condition, that had not been complied with, as to locating the road; but the conclusion of the court was rested partly on the view that the subscription itself was *void*, as being a fraud on the commonwealth, as well as upon unconditional subscribers.[4]

[1] Dayton &c. R. Co. *v.* Hatch, 1 Disney (Ohio), 84.

[2] Lane *v.* Brainard, 30 Conn. 565; Morrow *v.* Nashville Iron &c. Co., 87; Tenn. 262; *s. c.* 10 S. W. Rep. 495; 3 Pickle, 262; 3 L. R. A. 37.

[3] Mack's Appeal (Pa.) 7 Atl. Rep. 481; 5 Cent. Rep. 186. See also Wilmington &c. R. Co. *v.* Robeson, 5 Ired. L. (N. C.) 301; Mirick *v.* French, 2 Gray (Mass.), 420; Compare Converse *v.* Hood, 149 Mass. 471; *s. c.* 21 N. E. Rep. 878.

[4] Bavington *v.* Pittsburgh &c. R. Co., 34 Pa. St. 358; *Ante*, §§ 1306, 1309.

§ 1339. No Waiver if Note Obtained by Fraudulent Representation that Condition has been Complied with. — There is a view, as already seen,[1] that the subscriber is entitled to *notice* from the corporation of the performance of the condition. If, through its agents, it notifies the subscriber that the condition has been performed when such is not the fact, the giving by him of an absolute note for his subscription on the faith of this notification will not be deemed a waiver of the condition; but the note will be voidable at his election, on the ground of having been obtained from him by fraud and false representations.[2]

§ 1340. Recovery of Payment Made before Condition Complied with. — As the making of payment or the giving of an absolute promise to pay before the condition is complied with, is a *waiver* of it,[3] the subscriber cannot recover such payments from the corporation, provided they are voluntarily made.[4]

§ 1341. Failure to Carry out Advertised Projects. — A distinction must be taken between a *condition precedent* in a contract of subscription and a failure of the corporation to carry out projects announced in its prospectus, by means of which it has induced subscriptions. The mere failure of the company to carry out such a project will not, of course, avoid a subscription, or entitle him to maintain an action to recover it back; but to warrant such an action he must show some *misrepresentation* or *fraud*, or such an entire failure in the object and purpose of the

[1] *Ante*, § 1333.

[2] Taylor *v.* Fletcher, 15 Ind. 80.

[3] *Ante*, § 1336.

[4] Davenport &c. R. Co. *v.* Rogers, 39 Iowa, 298. A decision of the Supreme Court of Indiana seems hard to reconcile with these principles, or with any other except a desire to let out of a bad bargain a farmer who had been imposed upon. A. made a cash subscription for stock in a railway company; afterwards, induced by the promise of the company's agent that this cash subscription should not be called in until after completion of the road, he subscribed his farm; the company sued for the cash subscription, and were proceeding to enforce their judgment before the road was completed, whereupon A. sued to recover his farm, averring a tender of the stock given for it. It was held that, A., having made no resistance, on the ground of the promise, to the suit for the first subscription, was not entitled to a rescission of the contract; but that the company, having broken its contract, was liable to a suit for damages for the recovery, of which this complaint contained sufficient facts. Scarce *v.* Indiana &c. R. Co., 17 Ind. 193.

company, as amounts to a virtual dissolution.[1] So, it has been held that proof that promoters of a railroad scheme made public speeches in which they guaranteed that the route would pass near a certain tract, and that it deviated therefrom, will not discharge one who has subscribed in reliance on such statement, unless a *fraudulent intent* be established.[2]

§ 1342. Condition as to Completion of Corporate Enterprise.— On a theory similar to the above, it is generally held that a condition as to the time of the completion of the enterprise will *not* be regarded as a *condition precedent*, to be performed by the company before it can collect the subscription, unless the contract says so in express terms. The reason is, that the very object of the subscription is to raise funds for the carrying out of this enterprise, and hence such a construction of the contract would defeat its main purpose and make it nugatory.[3] But of course, parties make their own contracts, and the courts do not make contracts for them; and therefore if a subscriber to the stock of a railroad company expressly stipulates that his subscription is only to be payable when the road is completed to or through certain lands in a specified locality, there can be no recovery on the contract until it is so completed.[4]

§ 1343. Effect of Change of Location. — But it is plain that the foregoing rule, while perhaps an unavoidable interpretation

[1] Kelsey *v.* Northern Light Oil Co., 54 Barb. (N. Y.), 111.

[2] Braddock *v.* Philadelphia &c. R. Co., 45 N. J. L. 363.

[3] Johnson *v.* Kessler, 76 Iowa, 411; *s. c.* 41 N. W. Rep. 57; Armstrong *v.* Karshner, 44 Oh. St. 276; *s. c.* 24 N. E. Rep. 897; 44 Am. & Eng. Corp. Cas. 238. See for a statement of the principle, McGinnis *v.* Kortkamp, 24 Mo. App. 378.

[4] In a suit on a contract to pay to a railroad company a certain sum of money when its road should be completed through a particular county; provided it should pass through certain lands in a specified locality, it was held that an averment "that, accepting and acting on said agreement and subscription, said company did construct and build such railroad, and that the same was so far completed in accordance with said contract and agreement that, on" &c., "the same was ready for running cars thereon through said county," was not a sufficient averment of performance of the conditions of the contract to entitle the plaintiff to recover. Hayes *v.* Branham, 36 Ind. 219. Compare Cedar Falls &c. R. Co. *v.* Rich, 33 Iowa, 113; Swartwout *v.* Michigan &c. R. Co., 24 Mich. 389.

of the contract, may open the door to great frauds upon rural subscribers. The directors may pass a resolution making an ostensible or sham location, so as to comply with the conditions of particular subscriptions, and may after enforcing the collection of the subscriptions, change the location. This, it would seem, would create a *failure* of the *consideration* of the contract by matter subsequent, such as would entitle the subscriber to maintain an action to recover what he had paid thereunder upon tendering back his stock certificates; and, as already seen the principle does not apply in cases of *fraud*.[1]

§ 1344. Validity of Condition that Railway be Located on a Certain Route. — The courts have frequently held that a condition annexed to a subscription to the stock of a railroad company that it shall be located on a given route is a *valid condition precedent*, so that the company cannot enforce the payment of the subscription without showing that the road has been so located.[2] But, as already seen,[3] there is a limited view that such a contract of subscription with such a condition annexed is void and valueless for want of mutuality.[4]

§ 1345. This Condition Complied with by "Locating" without "Constructing." — There is a consensus of judicial opinion to the point that such a condition is complied with by *permanently locating* the road on the prescribed route, although it has not been *constructed* or *completed* on that route at the time when the payment of the subscription is demanded. It has been so held where the condition was that the road should "pass" through a certain county on a certain designated route;[5] or be "*located*" to a designated point;[6] or even "*located and con-*

[1] 2 *Ante*, § 1341.

[2] Jacks *v.* Helena, 41 Ark. 213; McMillan *v.* Maysville &c. R. Co., 15 B. Monr. (Ky.) 218; *s. c.* 16 Am. Dec. 181; Racine &c. Bank *v.* Ayres, 12 Wis. 512; Brownlee *v.* Ohio &c. R. Co., 18 Ind. 68; Evansville R. Co. *v.* Shearer, 10 Ind. 244; Jewett *v.* Lawrenceburg R. Co., 10 Ind. 539. To similar effect, Martin *v.* Pensacola &c. R. Co., 8 Fla. 371; New Albany R. Co. *v.* McCormick, 10 Ind. 499; *s. c.* 71 Am. Dec. 337, and cases in next section.

[3] *Ante*, § 1307.

[4] Macedon &c. Plank Road Co. *v.* Snediker, 18 Barb. (N. Y.) 317.

[5] North Missouri R. Co. *v.* Winkler, 29 Mo. 318.

[6] McMillan *v.* Maysville &c. R. Co., 15 B. Monr. (Ky.) 218; *s. c.* 61 Am. Dec. 181. Compare Missouri &c. R. Co. *v.* Thompson, 24 Kan. 178.

structed" on a certain route;[1] or "*permanently located and constructed*" through a certain town.[2] In all such cases the permanent or final location of the road which the contract contemplates is the *adoption by the directors of the route named*, and the contract is not broken until a different route is afterwards adopted.[3] The reason for this interpretation of the contract is that stated in a preceding section[4] that the undertaking must be construed so as to give effect to its main object, namely, the construction of the road. The postponement of payment until the work should be finished is regarded as inconsistent with the very end to be accomplished by the subscription, and hence is not within the intention of the parties to the contract. It has been held that notes given by a subscriber for capital stock in a railroad corporation, each note being given for an installment of his subscription, and each being made payable on completion of a twenty-mile section of the road, "ready for the cross-ties, trestles and bridges," of which completion, publication in a newspaper by the board of directors was to be conclusive notice, — mature as soon as such publication is made, although the notes describe the railroad as entitled to a certain privilege which has not then been secured, but the securing of which is not a condition precedent to payment for the stock.[5] In another case a stock subscription was made on condition that the road be located through A. Upon representations that the company was about so to locate it, notes were given for the stock. It was held that the payment of the notes was precedent to building, and that the fact that the intent of the company at the time the note was given was not so to locate, was no defense, so long as they had not located elsewhere, or otherwise disabled themselves from locating through A.[6]

[1] Miller *v.* Pittsburgh &c. R. Co., 40 Pa. St. 237; *s. c.*, 80 Am. Dec. 570.

[2] Berryman *v.* Cincinnati Southern Ry. Trustees, 14 Bush. (Ky.), 755.

[3] Smith *v.* Allison, 23 Ind. 366, 369; Ashtabula &c. R. Co. *v.* Smith, 15 Ohio St. 328; Miller *v.* Pittsburg &c. R. Co., 40 Pa. St. 237; *s. c.* 80 Am. Dec. 570.

[4] *Ante*, § 1342.

[5] Johnson *v.* Georgia &c. R. Co., 81 Ga. 725; *s. c.* 8 S. E. Rep. 531.

[6] Kellar *v.* Johnson, 11 Ind. 337; *s. c.* 71 Am. Dec. 355. See also Burlington &c. R. Co. *v.* Palmer, 42 Iowa, 218.

Article III. Interpretation of Particular Conditions.

§ 1349. That a Certain Sum be Subscribed. — Where a subscription is made on condition that a certain sum be subscribed by the *citizens* of a certain place, a subscriber is a citizen of that place, within the meaning of the condition, if he boards, does business, and spends nearly all his time there, although he is domiciled in another place.[1] - - - - A contract "to take and fill" a certain number of shares in the capital stock of a railroad corporation established in Maine, which by its charter is to consist of not less than 4,000 nor more than 10,000 shares, upon condition that "the corporation may organize when 4,000 shares shall have been subscribed, but no contract for the building and completing the road shall be entered into until 7,000 shares have been subscribed," renders the subscriber liable after 4,000 shares have been subscribed and the corporation has been organized and passed a vote to dispose of the residue of the capital stock authorized by the charter, although no other vote has been passed fixing the amount of the stock and the 10,000 shares have been taken.[2]

§ 1350. As to the Construction of the Company's Road or Works.— A proviso annexed to a subscription for railroad stock that the road should be put under contract within a year, and that no installments should be called for until it is put under contract with conditions to secure its building within twenty months from the time of

[1] Union Hotel Co. *v.* Hersee, 79 N. Y. 454; *s. c.* 35 Am. Rep. 536. Upon the question of the distinction between being a *resident* or an *inhabitant* of a certain place and being domiciled in that place, the court cite: Rex *v.* North Curry, 4 Barn. & C. 953; Matter of Wrigley, 8 Wend. (N. Y.) 141; Rex *v.* Allard, 4 Barn. & C. 772; Rex *v.* Nicholson, 12 East. 330. The word "citizen" has been interpreted as meaning resident in exemption laws: McKenzie *v.* Murphy, 24 Ark. 155; Cobb *v.* Coleman, 14 Tex. 594.

[2] Penobscot &c. R. Co. *v.* Bartlett, 12 Gray (Mass.), 244; *s. c.* 71 Am. Dec. 753.

the contract, constitutes a condition precedent.[1] - - - - Where a subscription is subject to a condition that a railroad shall be completed and in operation between two certain points by a day named, it will be sufficient to show *performance* of those conditions, and it is not necessary that the road should, on that day, furnish such facilities for receiving and discharging freight and passengers as could be expected of an established railroad, to make the party liable on his subscription. Proof that a depot was not built, and a station agent appointed for such place by the day named, will not necessarily defeat a recovery on the subscription.[2] - - - - A promissory note payable to the treasurer of the Chicago & Canada Southern Railway Company, was made "in consideration of the construction of" the railway, through or *within half a mile of the village of Dundee*, "within three years after this date, and the building of a passenger and freight depot" at Dundee; payable "in thirty days after said road and depot are constructed as aforesaid." The articles of incorporation of the company named Chicago as one of the *termini*. The track was laid through Dundee, and the depot was put up, but, instead of extending the road to Chicago, it was connected with other routes at a point beyond Dundee, so as to form a through line. It was held that the promise was made to afford aid in constructing the road, and was intended to be payable in case of the completion, as agreed, of the portion built, regardless of the failure to extend it to Chicago within three years, as stipulated.[3] - - - - Notes given by a subscriber for capital stock in a railroad, each note being for an installment, and payable on completion of a twenty-mile section of the road, "ready for the cross-ties, trestles and bridges," of which completion *publication in a newspaper* by the directors was to be conclusive notice, have been held due and payable as soon as the publication is made, though the notes described the road as one which was to have a certain *privilege*, and such privilege had not yet been secured. The securing of such privilege is not a condition precedent to payment, the specification thereof being merely a part of the description of the road as it was to be ultimately, but not as it was to be at maturity and on payment of the subscriptions.[4]

§ 1351. As to Assessments.— A condition that assessments shall not exceed five dollars on each share at one time is not violated by

[1] Burlington &c. R. Co. *v.* Boestler, 15 Iowa, 555. See also Henderson *v.* Railroad Co., 17 Tex. 560; *s. c.* 67 Am. Dec. 675; Connecticut & R. Co. *v.* Baxter, 32 Vt. 805.

[2] Ogden *v.* Kirby, 75 Ill. 555.

[3] Stowell *v.* Stowell, 45. Mich. 364.

[4] Johnson *v.* Georgia &c. R. Co. 81 Ga. 725; *s. c.* 8 S. E. Rep. 531.

making two or more assessments at one time, provided that no more than one payment of five dollars on each share is required at one time.[1] - - - - Where it was stipulated that two per cent. should be paid at the time of subscription, and three per cent. in three months from that date, and the remainder when called for and required by the president and directors; and the first two installments were not to be called for until March 1, 1853, it was held that the first two installments were payable on March 1, 1853, and that the latter was payable thereafter, at the discretion of the company, according to the terms of the contract.[2]

§ 1352. As to the Establishment of Depots at Certain Places. — Many of the subscriptions to the shares of railway companies which have been the subjects of judicial interpretation have been made on condition that the company shall *locate a depot* at a certain place. One of these ran as follows: "We, the subscribers, bind and obligate ourselves to subscribe to the capital stock of the North Missouri Railroad Company the sums set opposite our names, one-half the amount to be paid in six months, and one-half in twelve months from this date, on condition that a depot is located on the lands of John F. Diggs, which adjoin High Hill. This subscription is made to comply with the terms on which the directors of said company have made the location of a depot on said Diggs' land." It was held that this was a subscription *in prœsenti*, and not a mere engagement to subscribe *in future*, and that the subscription became absolute upon the location of the depot at the designated place.[3] - - - - This was well enough; but another court, out of undue complacency to a railroad company, construed away such a condition entirely. The case was that subscriptions to railroad stock were payable, one-fourth when the road should be finished to a certain county line, and the remainder in four equal installments of four months, as the work progressed through the county, provided the company should establish a depot on said road "at a certain point." The road was finished to a certain point beyond the county line, and then the company failed. The depot was not built. It was held that the provision as to building the depot was an independent covenant, and not a condition, and that the installments each fell due only as the work went on, there being a separate condition precedent as to each installment.[4] - - - - Equally indefensible was a decision of the Su-

[1] Penobscot &c. R. Co. *v.* Dunn, 39 Me. 587. See *ante*, § 1325.

[2] Roberts *v.* Mobile &c. R. Co., 32 Miss. 373.

[3] North Missouri R. Co. *v.* Miller, 31 Mo. 19.

[4] Paducah &c. R. Co. *v.* Parks, 86 Tenn. 554.

preme Court of Ohio in a case where a subscription was made for a given number of shares of stock of a railroad company, payable at such times and in such installments as the directors might prescribe, provided that the road should be "permanently located" on a specified route, and that "a freight house and depot be built" at a point named. The court held that the subscription became absolute upon the *permanent location* of the road, in accordance with the terms of the agreement. This was perhaps well enough;[1] but the court also held that the provision in relation to the erection of the building was a *stipulation* merely, and that its performance was not a condition precedent to the right to collect the amount of the subscription.[2] Just why the court should separate the conditions on which the contract depended and say that the part which the railroad company had performed was a condition precedent, but that the contract which the company had not performed was merely a stipulation, would be as difficult to answer as it would be to say why farmers and others subscribing to the stock of such companies should be held to their contracts while the companies should be excused from performance on their part. Courts have no rightful power thus to relieve people from the performance of their contracts, and if they had such power they ought not to exercise it so as to excuse corporate adventurers from performing their contracts while holding isolated individuals to the performance of theirs. - - - - The Supreme Court of Iowa proceeded with a better sense of justice in a case where a subscription list, designed to aid in the construction of a railroad, provided that a certain payment should be made when the road intersected with another "at Wheatland" and "has been permanently located to and within the limits of the town of Wheatland, with a station at the same." It was held that a construction of the road through the town and of the depot just outside of its limits was not a compliance with the terms of the contract.[3] - - - - The same court has held that a condition in a contract of subscription that a depot should be located within three-fourths of a mile of the corporate limits of the town of C., is complied with by locating a depot within that distance, measuring by a straight line, though the side tracks and switches were not.[4] - - - - The same court has held that a condition "that a depot be established within eighty rods of the present town of W.," is governed by the *recorded plat* of the town at the *date* of the note, and not by a subsequent *extension* of the town limits.[5]

[1] *Ante*, § 1345.

[2] Chamberlain *v.* Painsville &c. R. Co., 15 Ohio, St. 225.

[3] Davenport &c. R. Co. *v.* O'Connor, 40 Iowa, 477.

[4] Courtwright *v.* Strickler, 37 Iowa, 382.

[5] Davenport &c. R. Co. *v.* Rogers, 39 Iowa, 298.

§ 1353. That a Prescribed Route be Taken. — Where a subscription is made upon an agreement that a prescribed route be taken, and the company takes that route, the subscription becomes absolute, no matter what may be the terms of previous subscriptions.[1] - - - - Where the condition was that the railroad company should complete its road from B. to C., it was held that the company, in an action to enforce the contract, might show that, owing to the high lands near the city, it had not been contemplated by the parties that the road would be built *to the corporate limits* of B., but that the line of a previously constructed road was to be used for some distance; and that the nature of the ground might be shown as the reason why a particular route could not be chosen.[2] - - - - A condition that the railroad shall be located through a certain town, and shall cross the river north of B. street in said town, has been held to require the railroad to cross the river where a northerly line from the street would cross it, whether within or without the town.[3] - - - - Where a subscription contract provided that an order of the board of directors should be accepted as evidence that the required location had been made, it was held that this did not preclude other evidence of the fact, and that the actual construction of the road was the best evidence of compliance with the condition.[4]

§ 1354. Conditions Held to be not Conditions Precedent. — The tendency of the courts to construe away conditions in these contracts for the benefit of railroad companies is illustrated by a number and variety of decisions. Where a subscriber placed opposite his subscription the words, "To be expended between the C. River and the east line of the State," this was held not a condition precedent, but a mere "request."[5] Another court holds that a condition in a stock note that a side-track shall be constructed on the premises of the subscriber means that it should be constructed *after payment*, in the absence of a stipulation that it should be constructed before.[6] The same court holds that specifications in such a note that the road is to be operated independently of a certain existing railroad, relate to what is to be done *after* the notes are paid, and not before.[7] Where a condition of such a

[1] Spartanburg &c. R. Co. *v.* De Graffenreid, 12 Rich. L. (S. C.) 675; *s. c.* 78 Am. Dec. 476.

[2] Detroit &c. R. Co. *v.* Starnes, 38 Mich. 698.

[3] New Albany R. Co. *v.* McCormick, 10 Ind. 499; *s. c.* 71 Am. Dec. 337.

[4] Moore *v.* New Albany &c. R. Co., 15 Ind. 78. As to performance of the condition that "the road be built through the village of P," see Woonsocket Union R. Co. *v.* Sherman, 8 R. I. 564, 577.

[5] Lane *v.* Brainard, 30 Conn. 565.

[6] Johnson *v.* Georgia &c. R. Co., 81 Ga. 725; *s. c.* 8 S. E. Rep. 531.

[7] *Ibid.*

subscription was that the money should be paid "in installments of five per cent. so long as the work should be in actual progress," and that if the railway company named should fail to construct the road, then the amount subscribed should be paid on the same terms and conditions to any other company which would grade and tie a road between the points designated, it was held that the grading and tying were not conditions precedent to the payment of the subscription.[1] Another court, while upholding a condition that the subscription should be "null and void" unless a given amount should be subscribed, held that conditions as to the manner in which funds should be applied related only to matters of internal economy after the money had been paid in.[2]

§ 1355. Action of Committee: Judgment of Stockholders.— Where a committee is appointed by the subscribers to see that the stipulations in their subscriptions are complied with, of course the action of the committee is not a condition precedent to the right of the corporation to enforce the subscription, unless it has agreed to abide by the judgment of such committee.[3] On the other hand, where the subscription paper is delivered in *escrow* to a committee selected by the subscribers, with directions to turn it over to the corporation when the committee are satisfied that the company has complied with the conditions, the act of the committee in delivering it, in the exercise of their discretion, does not render the contract binding on the subscribers. The subscribers are not bound by the discretion of the committee. The question is whether the corporation has in fact complied with the conditions.[4] But a subscription to a fund for the building of a college which provides that "whenever a sum, sufficient in the judgment of the stockholders, shall be subscribed, there shall be a meeting of them called, and a permanent organization effected," does not bind the subscribers until a *permanent organization* has been effected, with their consent, and an expression of opinion obtained from the stockholders, as to the sufficiency of the amount subscribed to effect the object proposed.[5]

[1] Iowa &c. R. *v.* Bliobenes, 41 Iowa, 267.

[2] McGinnis *v.* Kortkamp, 24 Mo. App. 378; McGinnis *v.* Barnes, 23 Mo. App. 413. Facts under which it is held not a condition precedent to defendant's liability that plaintiff shall enter into a contract of a particular kind with the other corporation, and that, in an action to enforce his subscription, the subscriber cannot assail a contract thereafter made with such corporation, which has been ratified as provided: Cravens *v.* Eagle Cotton Mills Co., 120 Ind. 6; *s. c.* 21 N. E. Rep. 81, 984.

[3] Shaffner *v.* Jeffries, 18 Mo. 512.

[4] Davenport &c. R. Co. *v.* O'Connor, 40 Iowa 477.

[5] Goff *v.* Winchester College, 6 Bush (Ky.), 443.

§ 1356. Penalty for Non-Payment. — A clause of a subscription prescribing a penalty different from that designated in the charter, will be viewed either as nugatory, or as superadding a penalty to that stipulated by the charter, and will not be interpreted into a condition for the benefit of the subscriber.[1]

[1] Kirksey *v.* Florida &c. Plank Road Co., 7 Fla. 23; *s. c.* 68 Am. Dec. 426.

CHAPTER XXIV.

EFFECT OF FRAUD ON STOCK SUBSCRIPTIONS.

ARTICLE I. GENERAL PRINCIPLES.

§ 1360. Scope of this Chapter.— In this chapter it is proposed to consider those cases where persons have been, or, claim

to have been, by false and fraudulent representations, inveigled into subscribing for shares in corporations, or into purchasing shares of the stock of corporations when already organized,—including questions which grow out of the fraudulent over-issue of shares.

§ 1361. General Rule as to the Liability of a Corporation for the Frauds of its Agent in Procuring Subscriptions to its Stock.— It may be stated, as a general rule, that whenever the agent of a corporation, duly authorized by the corporation to procure subscriptions to its capital stock, induces persons to become subscribers to shares of such capital stock by fraudulent misrepresentations or concealments, the person so defrauded will be entitled to claim of the corporation a rescission of the contract, in the same manner as though the question had arisen between two natural persons,[1] — wherever the question arises *between the contracting parties* and the rights of third persons are not involved.[2] "The rule is universal that whatever fraud creates, justice will destroy."[3] Contracts to take stock in a corporation stand upon the same footing as all other conventional obligations. If induced by fraud, they create no obligation, and the injured party has a right to have them abrogated.[4]

§ 1362. Former Doctrine of the English Courts.— The English courts have generally leaned strongly against the view that one who has become a subscriber to shares in a company can escape the responsibilities of that situation by showing that he was induced to subscribe by false and fraudulent representa-

1 "Contracts of this description between an individual and a company, so far as misrepresentation or suppression of the truth is concerned, are to be treated like the contracts between any two individuals. For when a man makes a false statement which misleads another, the way in which that is to be treated affords the example for the way in which a contract is to be treated where the company makes a false statement which misleads an individual." Lord Romilly, in Directors *v.* Kisch, L. R. 2 H. L. 99. To the same effect are Smith *v.* Reese River Co., L. R. 2 Eq. 264; Vreeland *v.* New Jersey Stone Co., 29 N. J. Eq. 190; Upton *v.* Englehart, 3 Dill. (U. S.) 496; Smith's Case, L. R. 2 Ch. 604, 609; Custar *v.* Titusville Gas Co., 63 Pa. St. 381; Henderson *v.* Railroad Co., 17 Tex. 560.

2 *Post*, § 1433, *et seq.*

3 Runyon, V. C., in Vreeland *v.* New Jersey Stone Co., 29 N. J. Eq. 190.

4 *Ibid.*

tions. Some of those cases have, however, attempted a distinction between fraud committed by the *agent* of a company and fraud committed by the *company itself*. They have supposed that the agent of a corporation is not its agent for the purpose of committing a fraud, and have therefore concluded that it is not bound by his false representations. They have even held that if directors, in the course of the performance of their duty, make false or fraudulent representations addressed to shareholders, and afterwards give them an authorized circulation beyond the limits of the company, a stranger acting upon such representations, and suffering loss in consequence, has no remedy against the company, unless he can show that the *whole company*, were a party to the fraud.[1] But they, at the same time, conceded that the company would be answerable for his false representations *if acquiesced in at a general meeting*. When, therefore, a person was induced to take shares in a company, insolvent at the time, by false representations contained in a report of its directors and false accounts submitted by them at a general meeting, and, having discovered the company to be insolvent, he repudiated the shares, it was held that he was not a contributory.[2] But where A. became a shareholder and director in a company *on the representation of one of its directors* that it was in a flourishing condition, whereas it was on the verge of insolvency, it was held by the same learned judge that the misrepresentation, not being that of the company, did not relieve him from being a contributory.[3] So, where a person was induced to take shares by a promise of a promoter of the company, which promise was not kept, he was nevertheless a contributory, his remedy being only against the person who made the promise.[4] Whilst the *results* reached in these cases are, no doubt, in conformity with the general current of the authorities, English and American, there is now little room to doubt that the ground taken by Lord Romilly, and other English equity judges, that a corporation is not bound by the fraud of its agent, is, where no

[1] Ex parte Nichol, 5 Jur. (N. S.) 205; 28 Law J. Ch. (N. S.) 257.

[2] Ayre's Case, 25 Beav. 513, Sir John Romilly, M. R.

[3] Holt's Case, 22 Beav. 48. To the same effect see Barrett's Case, 3 De G. J. & S. 30.

[4] Felgate's Case, 2 De G. J. & S. 456.

other rights are concerned than those of the company and the person defrauded, fundamentally wrong; because, as corporations and joint-stock companies can only act through agents, it gives them an immunity in the commission of fraud, not extended to individuals.[1]

§ 1363. Continued: Doctrine of Oakes v. Turquand.— The efforts of those judges to arrive at a settled rule upon this subject culminated in the great case of *Oakes* v. *Turquand*, decided in the House of Lords in 1867.[2] In that case a person applied, on the faith of statements in a prospectus, for shares in a limited-liability company. They were allotted to him, and his name was put upon the register of shareholders. At the end of nine months the company failed, and was ordered to be wound up. The subscriber then applied to have his name removed from the list of contributories; but it was held by Lords Chelmsford, Cranworth, and Colonsay, affirming the doctrine of Vice-Chancellor Malins, that this could not be done. This case may be appealed to as announcing the following doctrines:

1. A contract induced by fraud is not void, but voidable; and therefore, though the persons who by their fraud induced it may not enforce it, yet *other persons* may, in consequence of it, acquire interests and rights which they may enforce against the party who has been so induced to enter into it.

2. When a person has been, by the fraudulent misrepresentations of directors, or by their fraudulent concealment of facts, drawn into a contract to purchase shares in a company, the directors cannot enforce the contract against him, but he may rescind it. But he must do this within a reasonable time. He cannot, after a failure of the company, relieve himself from liability to contribute to the payment of its debts on the ground that he has been ignorant of something which, with proper diligence, he might have known.

3. The direct remedy of a creditor of an incorporated company is solely against the company, and not against its individual members, as upon a contract with them. But though, as between the company and the member, the member might have a good

[1] See *post*, § 1367.

[2] L. R. 2 H. L. 325.

legal or equitable defense to a call upon himself, he may still be liable to contribute to the assets of the company for the purpose of satisfying the company's creditors.[1]

§ 1364. General Observations as to the Limitations of this Rule. — These obvious rules of justice have received application in many cases where the company had brought an *action to recover calls*[2] on a stock subscription fraudulently obtained, or where the subscriber had exhibited a *bill in equity to cancel such a subscription.*[3] But as we advance in this inquiry we shall see that the application of this rule has been generally denied where the company has become insolvent, and where the subscriber has been called upon to fulfill his contract *for the benefit of creditors.* We shall furthermore discover that the rule is subject to two distinct exceptions: 1. Where the subscriber has been guilty of *negligence* in informing himself of the actual facts. 2. Where, in consequence of his *delay* in repudiating the contract, innocent third parties, shareholders or creditors, have acquired rights which would be prejudiced by its rescission.[4]

§ 1365. Contracts Induced by Fraud not Void, but only Voidable. — The rule, then, is that the fact that a person has been

[1] This doctrine has been overturned by Waterhouse *v.* Jamieson, L. R. 2 H. L. (Sc.) 29, where it is held that the official liquidator, representing creditors, proceeds against shareholders only *in right of the company.*

[2] Cunninghan *v.* Edgefield &c. R. Co., 2 Head (Tenn.), 23; Crump *v.* U. S. Mining Co., 7 Gratt. (Va.) 352; *s. c.* 56 Am. Dec. 116; Wert *v.* Crawfordsville &c. R. Co., 19 Ind. 242; McDermott *v.* Harrison (Sup. Ct.) 30 N. Y. St. Rep. 324; *s. c.* 9 N. Y. Supp. 184. See also Young *v.* Erie Iron Co., 65 Mich. 111 (bill in equity by creditors).

[3] Vreeland *v.* New Jersey Stone Co., 29 N. J. Eq. 190. See also Directors *v.* Kisch, L. R. 2 H. L. 99; New Brunswick &c. Co. *v.* Muggeridge, 1 Drew. & Sm. 363, 381; Rawlins *v.* Wickham, 3 De G. & J. 304; National Exchange Co. *v.* Drew, 32 Eng. Law & Eq. 1; Waldo *v.* Chicago &c. R. Co., 14 Wis. 575.

[4] *Post,* § 1440. Directors *v.* Kisch, L. R. 2 H. L. 99; Ex parte Briggs, L. R. 1 Eq. 483. In Ellis *v.* Schmœck, 5 Bing. 521, the defendants had purchased the scrip of a mining company originated in fraud, and had attended one meeting of the company; but they never signed the partnership deed, were innocent of the fraud, and transferred their scrip before the plaintiff brought his suit, which was an action for goods sold to the company after the defendants had purchased their scrip. It was held that they were liable.

induced to enter into a contract by fraud does not make the contract void *per se*, but only voidable at his election.[1] This in reality is all that is meant by the expression that fraud vitiates all contracts. The rule means nothing more than that the person defrauded into making the contract has the right to claim a rescission, and that during the interval between the making of the contract and the time when he claims the rescission it is not void, but valid. This being so, the rescission takes effect from the time when it is made, or from the time when the legal proceedings to obtain it are commenced, and does not take effect, by relation, from the time when the contract was made. But this does not mean that the agreement subsists in full vigor until it is rescinded by a court of competent jurisdiction. It means that it subsists until it is repudiated by some distinct act of the person entitled to a rescission.[2]

§ 1366. Not Voidable unless the Relation of Principal and Agent Existed between the Corporation and the Person Making the Representation. — Recurring to principles of constant application in the law of frauds it may be stated, as a general proposition, that there is no obligation on the part of a corporation to rescind a contract of subscription to its capital stock, unless the relation of principal and agent subsisted between the corporation and the person making the false representation. This relation need not, however, have existed at the time the contract of subscription was made;[3] it may have arisen subsequently, constructively and by *relation*,— as where the corporation, after knowledge of the means by which a person acting gratuitously in its behalf had procured subscriptions to its capital stock, elects to *retain the fruits* of the transaction, and

[1] Oakes *v.* Turquand, L. R. 2 H. L. 325; Bwlch-y-Plwm Lead Mining Co. *v.* Baynes, L. R. 2 Exch. 324; Upton *v.* Englehart, 3 Dill. (U. S.) 496; Farrar *v.* Walker, *Id.* 506, n.; Reese River Mining Co. *v.* Smith L. R. 4 H. L. 64 (affirming *s. c.* L. R. 2 Eq. 264; L. R. 2 Ch. 604; reversing *s. c.* 36 L. J. Ch. 385); State *v.* Jefferson Turnpike Co., 3 Humph. (Tenn.) 305; Mixer's Case, 4 De G. & J. 575.

[2] These views are gathered from the remarks of Lord Hatherley, in Reese River Mining Co. *v.* Smith, L. R. 4 H. L. 64, 73. They were adopted by Dillon, J., in Upton *v.* Englehart, 3 Dill. (U. S.) 496.

[3] Walker *v.* Mobile &c. R. Co., 34 Miss. 245.

thereby *ratifies* the wrongful act and makes the wrongful actor its agent.

§ **1367. Authority of the Agent to Commit the Fraud.**— If this relation of principal and agent subsisted at the time of the making of the representations, it is, on grounds hereafter stated, wholly immaterial that the agent, in making them, transcended his authority.[1] Thus it is said by Baldwin, J., in an important case on this subject in the Court of Appeals of Virginia: "That a person professing to act as agent for another does so wholly without authority, or transcends the authority actually conferred upon him by his principal, is no reason for enforcing the contract against the other party, when obtained from him by false and fradulent representations."[2] Another court, in a well considered case, has reached substantially the same result by expressing the rule that where a corporation sends out an agent to procure subscriptions to its capital stock, any false and fraudulent representations made by such agent to effect this purpose will be deemed to have been made within the scope of his agency.[3] The Supreme Court of Alabama, in a case of this kind, has likewise declared it well settled that no one can hold an interest procured for him by the fraud of another, any more than if the fraud were committed by himself.[4] Therefore the fraudulent representation of the president and one of the directors of a railroad company, that the proposed railroad would be built on a given route, on the faith of which a person was induced to take shares, has been held sufficient to avoid the contract.[5] This subject was carefully considered by the Supreme Court of Pennsylvania, and several authorities examined.[6] "The principle of the cases," said Agnew, J., "would seem to be this: that where representations made by an agent to obtain subscriptions are a *part of a scheme of fraud* participated in by the officers authorized to manage its affairs,

[1] *Post*, Ch. 137.

[2] Crump *v.* United States Mining Co., 7 Gratt. (Va.) 352, 368, *s. c.* 56 Am. Dec. 116.

[3] Waldo *v.* Chicago &c. R. Co., 14 Wis. 575.

[4] Rives *v.* Montgomery Plank Road Co., 30 Ala. 92.

[5] *Ibid.* Compare *ante*, §§ 1287, 1288, 1306, 1353.

[6] Custer *v.* Titusville &c. R. Co., 63 Pa. St. 381, 386.

or where they are such that the agent may reasonably be presumed by the subscriber to have the authority of the corporation to make them, his representations may be given in evidence to show the fraud by means of which the subscription was procured. But when there is no reasonable presumption of authority, and no actual authority, to make them, the corporation should not be prejudiced by the unauthorized acts of the agent. Hence, when the representation of the agent is *contrary to the interests and duty of the corporation*, as that he will release or has authority to release the subscription he is taking, it is not a reasonable presumption that he has such authority, and a subscriber on such terms would be *particeps criminis*, and held to all the responsibilities of a *bona fide* subscriber. This is the very point decided in Robinson *v.* Pittsburgh &c. R. Co." [1]

§ 1368. **Rule in Case of Subscriptions Obtained by Public Commissioners.** — We have already alluded to the plan of organizing corporations in vogue at a former period in the history of corporate franchises in this country, whereby *commissioners* were appointed in pursuance of an act of incorporation to take subscriptions to the capital stock of the proposed company, and otherwise to superintend its organization.[2] These commissioners have been regarded as *public officers*, having no authority to make any representations touching the enterprise, though in point of fact they were often — perhaps generally — the mere tools or confederates of the adventurers who had obtained the charter. On the theory that they were public officers, the courts concluded that no one could justify himself in listening to their talk. As they were *agents of the State*, and not agents of the corporation, a subscriber could not avail himself of their frauds or violations of law;[3] nor were such frauds and violations of law ground of forfeiting the charter of the company.[4] And the distinction has been drawn that the fact that a subscription to the capital stock of a corporation was procured by *fraudulent* representations of its *agent* may be set up in bar of a recovery thereon; but not so as to sub-

[1] 32 Pa. St. 334; *s. c.* 72 Am. Dec. 792.

[2] *Ante*, § 1246 *et seq.*

[3] North Carolina &c. R. Co. *v.* Leach, 4 Jones (N. C.) 340.

[4] Commercial Bank *v.* State, 6 Smed. & M. (Miss.) 599.

scriptions procured by commissioners prior to the organization.[1] This distinction overlooks a principle stated in the preceding section that a corporation ought not to be permitted to take the benefit of a fraud committed by another, no matter who that other is. There was, however, good sense in the view that frauds of a private nature, taking place between the original subscribers to the stock of the corporation and the commissioners, could not be set up to the injury of subsequent *bona fide* purchasers of the stock.[2]

§ 1369. American Decisions Denying Right of Rescission for Fraud. — Fifty years ago American courts were much more affected in favor of the rights of corporations than they are now. Unconsciously no doubt, they often did their reasoning entirely on the side of the corporation, and proceeded in obtuse forgetfulness of the rights of scattered individuals. At or about that period a number of decisions were rendered which go to the length of holding that fraud cannot be set up by a subscriber to corporate shares in avoidance of his liability as a subscriber. The judges were in some cases ingenious and astute in inventing theories to take such cases out of the general principles of the law. One court held that a subscription to a joint stock is not only an undertaking with the company, but with all other subscribers; and hence that, even if fraudulent as between the subscriber and the corporation, it is to be enforced for the benefit of the others in interest.[3] But this court did not explain, and no court can explain, why the other parties to the undertaking, that is to say, the other stockholders, should be allowed to acquire benefits through a fraud practiced upon one of their number. It may be assumed that most of the American decisions rendered at this period of our jurisprudence, which have refused to release subscribers to corporate stock on the ground of fraud, have proceeded on tenable, or at least on plausible grounds. Those which have not, have undertaken to assert principles which have happily passed out of American jurisprudence; and the writer, having

[1] Rutz *v.* Esler &c. Man. Co., 3 Ill. App. 83.

[2] Minor *v.* Mechanics Bank, 1 Pet. (U. S.) 46, 66.

[3] Graff *v.* Pittsburgh &c. R. Co., 31 Pa. St. 489.

developed the principles on which the courts generally proceed, will not consume time in attempts to analyze and reconcile them.[1]

§ 1370. Effect of Ignorance of the Subscriber. — It is no defense for the stockholder to show *ignorance* of the condition and circumstances of the company when his subscription was taken.[2] If the company is governed by the laws of a foreign State, a person who subscribes for shares of its stock is bound to know the *law* of such *foreign State*.[3] But if a promoter or an agent of the corporation takes advantage of the ignorance of a person, and, by means of false representations which would not avail against an intelligent person, induces him to subscribe, he may claim a release on that ground.[4]

§ 1371. Rule of Law that Stockholder must have been Diligent in Discovering the Fraud. — The common law proceeds upon a moral plane so low as to allow *fraud* to be offset by mere *negligence;* that is to say, a party who has been defrauded by another cannot have a remedy against that other for the fraud,

[1] Compare the following cases: Buffalo &c. R. Co. *v.* Dudley, 14 N. Y. 336; Goodrich *v.* Reynolds, 31 Ill. 490; *s. c.* 83 Am. Dec. 240; Troy &c. R. Co. *v.* Kerr, 17 Barb. (N. Y.) 581; Case of Empire Bank, 18 N. Y. 199; *s. c.* 8 Abb. Pr. (N. Y.), 192. It has been held that the shareholder will not be released on the ground that the agent of the corporation, procuring the subscription, made false statements *as to the amount of stock subscribed*, and as to the time when the railroad would be completed. Brownlee *v.* Ohio &c. R. Co., 18 Ind. 68; Bish *v.* Bradford, 17 Ind. 490; Hardy *v.* Merriweather, 14 Ind. 203; Andrews *v.* Ohio &c. R. Co., 14 Ind. 169. Nor that he falsely represented that another railroad company would furnish the iron for the railroad proposed, or lend its credit for the purpose of obtaining it. Johnson *v.* Crawfordsville &c. R. Co., 11 Ind. 280. Nor will a fraudulent representation, made by one of the company's officers at a public meeting and in the presence of a majority of the board of directors, but not made in pursuance of any authority from, or resolution of, the board, discharge a subscriber. Buffalo &c. R. Co. *v.* Dudley, 14 N. Y. 337.

[2] Payson *v.* Withers, 5 Biss. (U. S.) 269.

[3] *Ibid.*

[4] In an action by a turnpike company on a stock subscription, the defendant answered that he *could not read* and did not hear the articles of association read; but that a party to them, interested in obtaining subscriptions, induced him to subscribe, by his false representation that the articles did not require a payment of subscriptions until $20,000 had been subscribed. It was held that these averments set up a sufficient ground of defense. Wert *v.* Crawfordsville &c. Co., 19 Ind. 242.

or cannot avoid the contract into which he has been drawn by the fraud, if he is negligent in discovering the fraud before he suffers the imposition.[1] This doctrine has been levelled against a subscriber to corporate shares who set up, in an action for assessments, that he had been induced to sign the subscription paper by the fact of other names being signed on it when it was presented to him, upon an agreement with the promoters of the company and such signers that their subscription should be fictitious and that they should not be held to it according to its terms. In other words, the court held, in effect, that the intending subscribers must suspect fraud, where every thing seemed fair and honest, and use diligence to discover in some way that this secret and nefarious arrangement had been made between commissioners appointed by the legislature to receive subscriptions and certain persons who were willing to lend their names as decoys to lure other subscribers.[2]

§ 1372. Duty of Purchaser to Make Inquiries before Subscribing. — But the rule of equity is that where there has been a fraudulent misrepresentation or wilful concealment of facts, by which a person has been induced to enter into a contract to subscribe for shares, it is, in theory of equity, no answer to his claim to be relieved from it, that he might have known the truth by proper inquiry.[3] This is but an application of the general

[1] Ormrod *v.* Huth, 14 Mees. & W. 651.

[2] Connecticut &c. R. Co. *v.* Bailey, 24 Vt. 465; *s. c.* 58 Am. Dec. 181, 189.

[3] Directors *v.* Kisch, L. R. 2 H. L. 99, 120; Smith *v.* Reese River Co., L. R. 2 Eq. 264; *s. c.* L. R. 4 H. L. 64; Waterhouse *v.* Jamieson, L. R. 2 H. L (Sc.) 29; Upton *v.* Englehart, 3 Dill. (U. S.) 496, 500; New Brunswick &c. R. Co. *v.* Muggeridge, 1 Dr. & Sm. 363, 382. In laying down this rule in Directors *v.* Kisch, *supra*, Lord Chelmsford, L. C., used the following language: "It appears to me that when once it is established that there has been any fraudulent misrepresentation or wilful concealment by which a person has been induced to enter into a contract, it is no answer to his claim to be relieved from it to tell him that he might have known the truth by proper inquiry. He has a right to retort upon his objection, 'You, at least, who have stated what is untrue, or have concealed the truth, for the purpose of drawing me into a contract, cannot accuse me of want of caution because I relied implicitly upon your fairness and honesty.' I quite agree with the opinion of Lord Lyndhurst, in the case of Attwood *v.* Small, 6 Cl. & Fin. 232, 395, that 'where representations are made with respect to the nature and

principles of equity applicable to all contracts induced by fraudulent misrepresentations or concealments. "Every contracting party has an absolute right to rely on the express statement of an existing fact, the truth of which is known to the opposite party, and unknown to him, as a basis of a mutual engagement; and he is under no obligation to investigate and verify statements to the truth of which the other party to the contract, with full means of knowledge, has deliberately pledged his faith."[1] It is not incumbent upon him to institute inquiries and to suspect fraud, where all seems fair and conformable to the requirements of the statutes.[2]

§ **1373. Illustrations of this Rule.** — Accordingly, a person buying stock from a corporation is entitled to rely upon the assurances of an officer of the corporation as to its financial condition; and although he may be already a stockholder, he is not bound to avail himself of his privilege of *examining the corporate books*, in order to avail himself of the defense of the fraudulent representations, when sued upon the note given for the shares. In such a case it was said: "Although the defendant had the right, as a stockholder, to inspect the books, and, by an examination might have ascertained whether the statement was true or false, an acquaintance with bank book-keeping, and considerable time would have been required for such an examination; and, under such circumstances, the defendant may rely upon the assurances of the officers of the bank, and not subject himself to the imputation of negli-

character of property, which is to become the subject of purchase, affecting the value of that property, and those representations afterwards turn out to be incorrect and false, to the knowledge of the party making them, a foundation is laid for maintaining an action in a court of common law to recover damages for the deceit so practiced; and in a court of equity a foundation is laid for setting aside the contract which was founded upon that basis.' And in the case of Dobell *v.* Stevens, 3 Barn. & Cress. 623, to which he refers as an authority in support of the proposition, which was an action for deceit in falsely representing the amount of the business done in a public house, the purchaser was held to be entitled to recover damages, although the books were in the house, and he might have had access to them if he thought proper."

[1] Mead *v.* Bunn, 32 N. Y. 275, 280, per Porter, J. To the same effect is McClellan *v.* Scott, 24 Wis. 81, 86; Attwood *v.* Small, 6 Cl. & Fin. 232, 395; Dobell *v.* Stevens, 3 Barn. & Cres. 623; Eaton *v.* Winnie, 20 Mich. 156; *s. c.* 4 Am. Rep. 377.

[2] Waterhouse *v.* Jamieson, L. R. 2 H. L. (Sc.) 29; Foreman *v.* Bigelow, 4 Cliff. (U. S.) 508, *s. c.* 7 Cent. L. J. 430.

gence for a failure to examine the books of the bank.[1] - - - - In another case the fraudulent prospectus stated that further information could be had at the office of the company. This was held not enough to put persons intending to apply for shares upon inquiry as to whether the statements in the prospectus were true or false.[2] So, where the prospectus of a railway company stated that "the engineer's report, maps, plans, etc., may be inspected, and further information obtained, at the office of the company," it was held that the neglect of the applicant for shares to examine these papers was no answer to his demand to be relieved from his contract.[3]

§ 1374. Rule not Applicable where Statements Ambiguous. — But this rule does not apply where the statements in a prospectus are *ambiguous* and susceptible of an interpretation conformable to the truth. Here there is good sense in holding the purchaser bound to avail himself of the means of inquiry open to him, and to which he is referred by the prospectus in question, before he can charge fraud on the directors or promoters of the company.[4]

§ 1375. Subscriber Owes Duty of Inquiry to Innocent Third Persons. — But, as we shall more fully see hereafter,[5] while one contracting party owes, in theory of equity, to the other contracting party no duty to inquire before entering into the contract, he may owe a duty of subsequent inquiry *to innocent third persons;* for instance, to *creditors* of the company, who may have

[1] Union Nat. Bank *v.* Hunt, 76 Mo. 439, 445; reversing *s. c.* 7 Mo. App. 42. *Contra,* see Haskell *v.* Worthington, 94 Mo. 560, 570, per Brace, J.

[2] Smith *v.* Reese River Co., L. R. 2 Eq. 264.

[3] Directors *v.* Kisch, L. R. 2 H. L. 99.

[4] Hallows *v.* Fernie, L. R. 3 Ch. 467, 477. In this case Lord Chelmsford made the following broad statement, which, though correct when considered with reference to the facts of the particular case, cannot be justified as an abstract proposition, in the view of later decisions of the House of Lords and other courts of equity: "If a person purchases shares in a company upon the faith of a prospectus, and is referred to any document which will show the untruth or inaccuracy of any of its statements, and he chooses not to make use of his means of knowledge, but to continue in a state of wilful ignorance of the facts, he cannot afterwards be heard to complain that he has been deceived by the alleged misstatements."

[5] *Post,* § 1438, *et seq.*

given credit on the faith of his being a shareholder;[1] and it is upon this ground, as we shall hereafter see, that he is bound to disaffirm the contract at the earliest opportunity after notice of the fraud practiced upon him.[2]

§ 1376. **Waiver of the Fraud by the Subscriber.** — The principle hinted at in the preceding section, and more fully developed in the next section, is, that one induced by fraud to purchase shares of stock in a corporation cannot avoid his purchase if, after becoming aware of the fraud, he *acts as a shareholder* or derives a benefit from his shares.[3] Nor can a stockholder set up, by way of defence, fraud practised by the corporation on him in its acts or organization, where he has stood by and interposed no objection while the corporation has contracted debts.[4] And while it is in general true that where a corporate charter has been obtained by means of *fictitious subscriptions* for a part of the stock, and fraud has been committed on a real subscriber by which he has sustained or might sustain damage, — no action can be maintained against him by the corporation for the amount of his subscription, — yet it is different where such subscriber has accepted the charter and by his own acts assisted in putting it into operation. In such a case he cannot avail himself, when sued by the corporation in respect of his subscription, of the defence that a part of such stock was fictitious.[5]

§ 1377. **Acts of Ratification or Estoppel.** — The underlying principle of the preceding section has already been stated:[6] it is that a contract to take shares induced by fraudulent misrepresentations or concealments is not only valid until rescinded,[7] but it may become absolutely binding by acts of ratification. And

[1] See Oakes *v.* Turquand, L. R. 2 H. L. 325; Reese River Mining Co. *v.* Smith, L. R. 4 H. L. 64; Saffold *v.* Barnes, 39 Miss. 399; National Park Bank *v.* Nichols, 2 Biss. (U. S.) 146; *s. c.* Myer Fed. Dec. §§ 211, 212.

[2] *Post,* § 1438, *et seq.*

[3] City Bank *v.* Bartlett, 71 Ga. 797; National Park Bank *v.* Nichols, 2 Biss. (U. S.) 146; *s. c.* 10 Myer Fed. Dec. §§ 213, 214.

[4] Beck *v.* Henderson, 76 Ga. 360.

[5] Centre &c. Turnpike Co. *v.* M'Conaby, 16 Serg. & R. (Pa.) 140; *ante,* § 1323; *post,* § 1956.

[6] *Ante,* § 1363.

[7] Reese River Co. *v.* Smith, L. R. 4 H. L. 64.

here it may be stated, generally, that if a person who has been thus entrapped into the purchase of shares, after discovering the fraud, acts in a manner inconsistent with an intention to disaffirm the contract, this will preclude him from disaffirming afterward.[1] This was held to be the effect of the following acts: after discovering the real facts, placing his shares in the hands of a broker and instructing him to sell them;[2] after coming to the knowledge of the alleged fraudulent representations, paying a call and receiving a dividend;[3] knowingly suffering his name to appear on the books of the company as a stockholder so long that the rights of creditors would be prejudiced in case of withdrawal;[4] participating in the meetings of the company,[5] but not where he merely appeared for the purpose of demanding a rescission of his contract;[6] voting his shares by proxy;[7] paying calls;[8] serving as a director, and participating generally in the business of the company;[9] demanding and suing for dividends;[10] promising to pay the installments due on his shares;[11] and receiving dividends, where the question arose as between the shareholder and creditors.[12] But the fact that a subscriber to stock

[1] Scholey *v.* Central Railway Co. of Venezuela, L. R. 9 Eq. 266, n.

[2] Ex parte Briggs, L. R. 1 Eq. 483, per Lord Romilly, M. R.

[3] Scholey *v.* Central Railway Co. of Venzuela, L. R. 9 Eq. 266, n.

[4] Matter of Reciprocity Bank, 22 N. Y. 17; McHose *v.* Wheeler, 45 Pa. St. 32; Philadelphia &c. R. Co. *v.* Cowell, 28 *Id.* 329; *s. c.* 70 Am. Dec. 128. Otherwise, where one is so held out without his knowledge. Fox *v.* Clifton, 6 Bing. 776.

[5] Dayton, &c. R. Co. *v.* Hatch, 1 Disney, (Oh.), 84; Harrison *v.* Heathorn, 6 Man. & G. 81, 84; Chaffin *v.* Cummings, 37 Me. 76.

[6] Wontner *v.* Shairp, 4 C. B. 404.

[7] Greenville &c. R. Co. *v.* Coleman, 5 Rich. L. (S. C.) 118; McCully *v.* Pittsburgh &c. R. Co., 32 Pa. St. 25.

[8] Graff *v.* Pittsburgh &c. R. Co., 31 Pa. St. 489; Cromford &c. R. Co. *v.* Lacey, 3 You. & J. 80; Frost *v.* Walker, 60 Me. 468; Hall *v.* U. S. Ins. Co., 5 Gill (Md.), 484; Mississippi &c. R. Co. *v.* Harris, 36 Miss. 17. But failing to pay calls does not, of course, imply that one is not a shareholder. Schaeffer *v.* Missouri Home Ins. Co., 46 Mo. 248; McHose *v.* Wheeler, 45 Pa. St. 32. But see Fiser *v.* Mississippi R. Co., 32 Miss. 359; Hayne *v.* Beauchamp, 5 Smedes & M. (Miss.) 537; Lewis *v.* Robertson, 13 *Id.* 558.

[9] Hays *v.* Pittsburgh &c. R. Co., 38 Pa. St. 81; Hager *v.* Cleveland, 36 Md. 476; Ruggles *v.* Brock, 6 Hun (N. Y.), 164.

[10] Philadelphia &c. R. Co. *v.* Cowell, 28 Pa. St. 329; *s. c.* 70 Am. Dec. 128.

[11] Mississippi &c. R. Co. *v.* Harris, 36 Miss. 17.

[12] Hoare's Case, 2 John. & H. 229; Gouthwaite's Case, 3 De G. & Sm. 258; Philadelphia &c. R. Co. *v.* Cowell, 28 Pa. St. 329; *s. c.* 70 Am. Dec. 128. And see Grace *v.* Smith, 2 W. Black. 998; Waugh *v.* Carver, 2 H. Black. 235; *s. c.* 1 Smith's Ld. Cas. 968; Pott *v.*

in a company has *sold some of the shares* taken by him, does not deprive him of the right to have the contract, it being *severable*, rescinded as to the remainder, for fraudulent misrepresentations in the company's prospectus, if he parted with the shares sold before discovering the fraud.[1]

§ 1378. Rule where Subscription is Settled by Negotiable Instrument. — If the subscription is settled by the giving of a negotiable instrument, *e. g.*, a negotiable promissory note secured by a mortgage, and this is negotiated by the corporation to an innocent third party before maturity, on a rule of public policy which upholds the confidence of the business community in dealing in commercial paper, he takes it discharged of equities subsisting between the maker and the payee, and the maker cannot defend against his liability on it by showing that he was induced to subscribe for the shares by false and fraudulent representations of the corporation or its agents.[2]

§ 1379. Subscriptions Given in Consequence of Mistake. — The grounds upon which courts of equity proceed in reforming contracts in consequence of mistake are familiar. The mistake must be mutual; and the courts, in reforming the contract and enforcing it as reformed, do no more than bring about the result which the contracting parties themselves intended.[3] It has been held that where individuals, having a design to be incorporated for the purpose of creating a water-power, cause surveys and estimates to be made of the water-power which can be created, and thereupon represent it to be greater than it really is, but

Eyton, 3 C. B. 32; Wightman *v.* Townroe, 1 Mau. & Sel. 412; Berthold *v.* Goldsmith, 24 How. (U. S.) 536, 542; Re Francis, 7 Nat. B. R. 359; *s. c.* 2 Sawyer (U. S.), 289. Compare Bowas *v.* Pioneer Tow Line, 2 Sawyer (U. S.), 21; Hazard *v.* Hazard, 1 Story (U. S.), 375; The Crusader, 1 Ware (U. S.), 441; Bigelow *v.* Elliot, 1 Cliff. (U. S.) 33; Winship *v.* Bank of United State, 5 Pet. (U. S.) 562, 574; Phœnix Ins. Co. *v.* Hamilton, 14 Wall. (U. S.) 508. But when a husband receives dividends for his wife (Ness *v.* Angas, 3 Exch. 805), or a trustee for his *cestui que trust* (Ness *v.* Armstrong, 4 Ex. 21), the rule may be otherwise. See also Bosanquet *v.* Shortridge, 4 Exch. 698.

[1] *Ex Parte West,* 56 Law Times (N. S.) 622.

[2] Andrews *v.* Hart, 17 Wis. 297.

[3] Bishop on Con., § 236.

without any intention to deceive, persons who subscribe for stock in the corporation on the faith of such representations, and agree to be personally liable for assessments, cannot avoid the contract on the ground of the mistake.[1] But it is said, in a Tennessee case, that if a person is induced to take stock in a railway company by false representations which are not fraudulent, and which form no part of the contract of subscription, he is not entitled to be relieved from the payment of the amount of his subscription. If, however, he acts on such representations, to his injury, he is entitled to relief, although they may have been innocently made.[2] Both of these cases, however, arose between the company and the shareholders.

Article II. What Frauds will and What will not Avoid the Contract.

[1] Salem Mill-Dam Corp. *v.* Ropes, 9 Pick. (Mass.) 187; *s. c.* 19 Am. Dec. 363.

[2] Cunningham *v.* Edgefield &c. R. Co., 2 Head (Tenn.), 23.

§ 1382. **Statement of the General Rule by Lord Romilly, M. R.**[1]— Concerning the general nature of the concealments and misrepresentations which will avoid such a contract, there is perhaps no better expression of opinion to be found than that of Sir John Romilly, M. R., in Pulsford *v.* Richards:[2] "The ground on which relief is asked is that principle of equity which declares that the wilful misrepresentation of one contracting party which draws another into a contract, shall at the option of a person deceived, enable him to avoid or enforce that contract. It will be convenient in the present case, to state my view of this principle before applying it to the facts, as they appear to be established on the evidence. The basis of this, as well as of most of the great principles on which the system of equity is founded, is the enforcement of a careful adherence to truth in all the dealings of mankind. This principle is universal in its application to cases of contract. It affects not merely the parties to the agreement, but also those who induce others to enter into it. It applies not merely to cases where the statements were known to be false by those who made them, but to cases where statements, false in fact, were made by parties who believed them to be true, if in the due discharge of their duty they ought to have known, or if they had formerly known and ought to have remembered, the fact which negatived the representation made; a strong illustration of which is to be found in Burrowes *v.* Lock.[3] And I held the same in Money *v.* Jorden.[4] This principle applies to all representations made on

[1] 22 L. J. (Ch.) 562; *s. c.* 47 Jur. 865.

[2] 22 L. J. (Ch.) 569; *s. c.* 17 Jur. 865; 19 Eng. L. & Eq. 387, 391.

[3] 10 Ves. 470.

[4] 21 L. J. (Ch.) 531; *s. c.* 11 Eng. L. & Eq. 182; 21 L. J. (Ch.) 893; 13 Eng. L. & Eq. 245.

the faith of which other persons enter into agreements; so that, whether the representation were true or false at the time when it was made, he who made it shall not only be restrained from falsifying it hereafter, but shall, if necessary, be compelled to make good the truth of that which he has asserted. The results, however, which flow from the application of this principle, differ materially, in different cases. In the case where the false representation is made by one who is no party to the agreement entered into on the faith of it, the contract cannot be avoided, and all that equity can then do is to compel the person who made the representation to make good his assertion as far as may be possible. In cases, however, where the false representation is made by a person who is a party to the agreement, the power of equity is more extensive, and the contract itself may be set aside, if the nature of the case and the condition of the parties will admit of it, or the person who made the sssertion may be compelled to make it good. The distinction between the cases where the person deceived is at liberty to avoid the contract, or where the court will affirm it, giving him compensation only, is not very clearly defined. This question usually arises on the specific performance of contracts for the sale of property; and the principle which governs the case, though it is in some instances of difficult application, and leads to refined distinctions, is the following, namely, that if the representation made be one which can be made good, the party to the contract shall be compelled, or may be at liberty, to do so; but if the representation made be one which cannot be made good, the party deceived shall be at liberty, if he pleases, to avoid the contract. Thus, if a man misrepresents the tenure or situation of an estate, as if he says an estate is freehold which proves to be copyhold or leasehold, or if he describes it as situate within a mile of some particular town, when, in truth, it is several miles distant, such a misrepresentation of it, if it cannot be made true, would at the option of the party deceived annul the contract; but if the property be subject to incumbrances concealed from the purchaser, the seller must make good his statements and redeem those charges. And, even in the cases where the property is subject to a small rent not stated, or the rent of it is somewhat less than it was represented, and the court does not annul the

contract, but compels the seller to allow a sufficient deduction from the purchase-money, it does so on this principle, that by these means he, in fact, makes good his representation, and that the statement made was not such as in substance deceived the purchaser as to the nature and quality of the thing he bought. With respect to the character or nature of the misrepresentation itself, it is clear that it may be positive or negative; that it may consist as much in the suppression of what is true, as in the assertion of what is false; and it is almost needless to add, that it must appear that the person deceived entered into the contract on the faith of it. To use the expression of the Roman law, so much commented upon in the argument before me, it must be a representation *dans locum contractui*, that is a representation giving occasion to the contract, the proper interpretation of which appears to be the assertion of a fact on which the person entering into the contract relied, and in the absence of which it is reasonable to infer he would not have entered into it; or the suppression of a fact, the knowledge of which it is reasonable to infer would have made him abstain from the contract altogether."

§ 1383. Fraud may Consist either in Misrepresentation or Suppression of the Truth.— The fraud which will entitle a subscriber to shares of a corporation or joint-stock company to a rescission may be either of a positive or negative kind. It may consist either in a suppression of what is true, or in assertion of what is false.[1]

[1] Pulsford *v.* Richards, 22 L. J. (Ch.) 569; *s. c.* 17 Jur. 865; 19 Eng. L. & Eq. 387, 391; Crump *v.* U. S. Mining Co., 7 Gratt. (Va.) 352; *s. c.* 56 Am. Dec. 116; Upton *v.* Englehart, 3 Dill. (U. S.) 496; *s. c.* 10 Myer Fed. Dec. § 199. In Henderson *v.* Lacon, L. R. 5 Eq. 249, 262, Vice-Chancellor Wood, after reviewing the facts of a case in which the plaintiff had been induced by fraudulent representations in a prospectus to take shares in a proposed company, said: "I must say I think the result of all the cases which have occurred shows the great value of that golden legacy, if I may so term it, which has been left to us by Sir Richard Kindersley, who has condensed in few words the whole doctrine as to the rule of conduct between shareholders and their directors, in the case of the New Brunswick & Canada R. Co. *v.* Muggeridge, 1 Dr. & Sm. 363, a case cited with approbation in the case of Directors *v.* Kisch, L. R. 2 H. L. 113, in the House of Lords." This "golden legacy" consists in the following words: "Further, it appears to me that it is quite necessary to uphold this as a

§ **1384. Must be a Material Inducement to the Contract.**— It must also appear that the person deceived entered into the contract on the faith of it. To borrow an expression from the Roman law, frequently used in cases of this kind, it must have been a misrepresentation or concealment *dans locum contractui;* which is understood to mean a misrepresentation or concealment giving occasion to the contract — the assertion of a fact on which the person entering into the contract relied, and in the absence of which it is reasonable to infer that he would not have entered into it; or the suppression of a fact, the knowledge of which, it is reasonable to infer, would have made him abstain from the contract altogether.[1] Another expression of this principle is that the fraudulent representation must have been a *proximate or immediate cause* or inducement to the purchase of the shares. It seems that if such fraudulent representations formed a *material part* of the inducement to take the shares, and that, but for them, the purchase would not have been made, their effect is not destroyed by the fact that *other influences* at the same time were at work, which contributed to the success of the false representations.[2] But where fraudulent reports on the part of the directors

principle: that those who issue a prospectus holding out to the public the great advantages which will accrue to the persons who will take shares in a proposed undertaking, and inviting them to take shares on the faith of the representations therein contained, are bound to state everything with strict and scrupulous accuracy; and not only to abstain from stating as facts that which is not so, but to omit no known fact within their knowledge, the existence of which might in any degree affect the nature, or extent, or quality of the privileges and advantages which the prospectus holds out as inducements to take shares." New Brunswick &c. R. Co. *v.* Muggeridge, 1 Dr. & Sm. 363. It is to be regretted that courts of conscience, so-called, do not always give effect to these salutary principles. The Supreme Court of Iowa have held that officers of corporations who hold out to individuals or to the public the advantages which will accrue to persons who take shares, thereby inducing them to take them, are bound not only to abstain from stating as facts that which is not true, but to omit no fact within their knowledge the existence of which might affect the advantages held out as inducements. Hubbard *v.* Weare, 79 Iowa, 678; *s. c.* 44 N. W. Rep. 915. See the charge of Drummond, J., in National Park Bank *v.* Nichols, 2 Biss. (U. S.) 146, as to the duty of persons soliciting such subscriptions to make full disclosures.

[1] Pulsford *v.* Richards, 22 L. J. (Ch.) 569; *s. c.* 17 Jur. 865; 19 Eng. L. & Eq. 387, 391. See the language of the opinion, *ante*, §1382.

[2] Lord Cranworth, in Nicol's Case, 3 De G. & J. 420.

are made the ground for the rescission of such a contract, the fraud is not to be established by *impressions* received from these reports *at some former period*, however distant; but they should be clearly shown to have been in the mind of the person at the time of the negotiations for the purchase, and to have been one of the causes leading to the contract.[1] Accordingly, where the directors of a bank made a false statement of its condition at the general meeting of its shareholders, and afterwards, the manager of the bank employed an agent to endeavor to get the plaintiff to subscribe for shares, but it did not appear that he had any authority from the directors to do so, and the agent made false representations to the plaintiff concerning the bank, but it did not appear that the agent had any authority from the manager of the bank to make any representations concerning its condition, — this, it seems, was not a case where the fraud of the directors or any authorized agent of the company was the proximate inducement to the purchase, and an action for a rescission was not maintainable on that ground.[2]

§ 1385. Further in Illustration of this Principle. — On like grounds, where a person seeking a rescission had visited the mine which the company proposed to work, attended the first meeting of the company, and knew as much about the prospects of the enterprise as the directors who put forth the exaggerated prospectus, it was held that he could not be relieved from his contract; for the inducement to his entering into the contract was presumed to have been his own knowledge, and not the prospectus.[3] - - - - So, upon the establishment of a railway, a person who had been instrumental in forming the company and in procuring the grant from the government, obtained from the directors an agreement to pay him a large percentage upon the capital of the

[1] Lord Cranworth, in Western Bank of Scotland *v.* Addie, L. R. 1 H. L. (Sc.) 145, 158.

[2] *Ibid.* 159. "Therefore," said Lord Cranworth, after stating the above facts, "though this was a case in which, as the pursuer was seeking to rescind a contract from which the company had derived benefit, his action was maintainable, yet I entertain considerable doubt whether, in his statement, he connected the directors sufficiently with the alleged misrepresentations to make them imputable to the company, and whether he did not fail to state a relevant case upon the record on this ground."

[3] Jennings *v.* Broughton, 22 L. J. (Ch.) 585; *s. c.* 17 Jur. 905; 19 Eng. L. & Eq. 420. To the same effect is Salem Mill Dam Corp. *v.* Ropes, 9 Pick. (Mass.) 187, 197.

company, to allot him four thousand shares, and to guarantee him a salary of £500 a year as a general manager of the company. The directors also allotted to themselves twenty thousand shares and ten thousand additional shares for themselves and other persons. These facts were suppressed in the prospectus which they subsequently issued; which, however, did state that they had reserved to themselves a commission of three per cent. upon the capital, by way of reimbursement for the expenses, liabilities and payments already incurred. Upon a bill by an original shareholder to be relieved from his shares and to obtain payment of his deposit-money and calls, with interest, it was held that the omission to state these facts in the prospectus was not such a misrepresentation or concealment as would induce the court to set aside the contract; for the concealment was of a matter which was not a material inducement to the contract.[1]

§ 1386. Illustrations Continued.—In another case an allottee of shares of a railway company brought his action for the recovery of a deposit paid upon his shares. The company had issued a prospectus which had stated the capital to consist of sixty thousand shares of £25 each, and the plaintiff, after having paid the deposit, executed the subscribers' agreement, which contained the usual terms as to the disposition of deposits. At the time when he executed the deed, the deposits upon eighteen thousand one hundred and sixty shares only had been paid, although thirty-five thousand shares had been allotted, which fact was not communicated to him. In an action for the deposit-money it was held that the suppression of this fact did not amount to such a fraud as to avoid the deed, and that the plaintiff was not entitled to recover back his deposit.[2] - - - - Nor can such a subscription be avoided on the ground that the agent who procured it obtained from an influential person in the neighborhood, whom he represented to be well acquainted with such matters, a colorable subscription for stock in the company, and presented such subscription to the subscriber and others as *bona fide*, to induce them to take stock, unless it also appears that he relied upon that fact and was induced thereby to make the subscription.[3] - - - - Where a subscriber to stock of a company seeks to rescind his contract to take shares on the ground of misrepresentation, it is not necessary that he should prove that if the representation had not been made he *would not have taken the shares;* it is suffi-

[1] Pulsford *v.* Richards, 22 L. J. (Ch.) 569; *s. c.* 17 Jur. 865; 19 Eng. L. Eq. 387.

[2] Vane *v.* Cobbold, 1 Exch. 798; *s. c.* 17 L. J. (Exch.) 97; 12 Jur. 60.

[3] Walker *v.* Mobile & Ohio R. Co., 34 Miss. 245.

cient if there is evidence to show that he was *materially influenced* by the misrepresentation.[1]

§ 1387. **Purpose of the Misrepresentations.** — Moreover, the misrepresentations must have been made *for the purpose of deceiving* the person complaining, or the general class of persons to which he belonged. Accordingly, if a misrepresentation as to the affairs of the company has been made by its board of directors, and A., seeing and believing this misrepresentation, is thereby induced to purchase shares of B., a shareholder, he cannot on these grounds escape liability as a contributory on the winding-up of the company; for the representations were not made to him, nor for the purpose of deceiving him.[2] But it is not to be inferred that such a fraudulent misrepresentation must have been made with the view of deceiving a particular individual or specific number of individuals. A fraudulent prospectus or report concocted by the directors of a company for the purpose of *deceiving the public* generally, as to its condition, with the view of inducing the public to purchase its shares, will, if seen, believed and acted upon by any member of the public, afford ground for avoiding his contract of subscription.[3] On like grounds, it has been held that a public advertisement, touching the allotment of shares in a joint-stock company, is presumed to have been communicated to all who were interested in the project. When, therefore, such an advertisement contained false statements, which inveigled a provisional subscriber for shares into paying an installment of his subscription, he was entitled to recover the money from the promoters of the enterprise.[4] The author conceives that there is no well grounded exception to this principle, so far as the rights of the *first subscriber* or *allottee* are concerned; [5] but whether the prin-

[1] Carling *v.* London &c. Bank, 56 L. J. (Ch.) 321.; *s. c.* 56 L. T. (N. S.) 115; 35 Week. Rep. 344.

[2] Ex parte Worth, 4 Drew. 529; Ex-parte Brigg, L. R. 1 Eq. 483. This last case, however, really turned upon the ground that it did not appear that the shareholder in question had actually seen the fraudulent reports.

[3] Ayre's Case, 25 Beav. 513; dicta in Cross *v.* Sackett, 2 Bosw. (N. Y.) 617.

[4] Wontner *v.* Shairp, 4 C. B. 404.

[5] This was conceded in the great case of Peek *v.* Gurney, L. R. 6 H. L. 377; *s. c.* Thomp. Off. Corp. 309; 8 Moak Eng. Rep. 1.

ciple extends to *his vendee* there is a difference of opinion, as we shall point out when discussing the liability of directors.[1]

§ **1388. Fraud Need not have been Willful.** — It is not necessary, in a court of equity, that the fraud should have been willful in order to entitle the defrauded shareholder to a recission, although it may be in a court of law.[2] In such cases, courts of equity, for obvious reasons, do not concern themselves with the *knowledge* and *motives* of those who put forth the misrepresentations; but look rather to the character and extent of the misrepresentations themselves, their effect upon the conduct of the person deceived by them, and the extent to which his rights have been thereby prejudiced. If the directors or other agents of the company put forth a false report concerning its affairs, it is immaterial that they do not know that it is false; for it is their duty to know it, and in all such cases negligent ignorance has the same weight in the juridical balance as actual knowledge.[3] The extent to which this principle is carried was well stated by Willes, J., in charging a jury in an action for calls, where the defense was fraud in procuring the subscription. "The defendant," said he, "no doubt is bound to make out a case of moral fraud, but that does not necessarily involve a knowledge of falsehood. It is a fraud to state things which are untrue, for the purpose of gain; whether the statement is made with a knowledge of their untruth, or with a reckless disregard of whether they are true or false, if it be with the intention of misleading another. To state things knowing them to be false,

[1] *Post*, §4144, *et seq.*

[2] *Post*, § 1470. For the rule at law, see Goodrich *v.* Reynolds, 31 Ill. 490; *s. c.* 83 Am. Dec. 240; Nelson *v.* Luling, 4 Jones & Sp. (N. Y.) 544; Salem Mill-Dam Corp. *v.* Ropes, 9 Pick. (Mass.) 187; *s. c.* 19 Am. Dec. 363. In Glamorganshire Iron &c. Co. *v.* Irvine, *infra*, the rule of equity was substantially applied at law; and American courts have acted upon the same principle: Cunningham *v.* Edgefield &c. R. Co., 2 Head (Tenn.), 23; Crump *v.* U. S. Mining Co., 7 Gratt. (Va.) 352; *s. c.* 56 Am. Dec. 116.

[3] Pulsford *v.* Richards, 22 L. J. (Ch.) 569; *s. c.* 17 Jur. 865; 19 Eng. L. & Eq. 387; Burrowes *v.* Lock, 10 Vesey, 470; Money *v.* Jorden, 21 L. J. (Ch.) 531; *s. c.* 11 Eng. L. & Eq. 182; 21 L. J. (Ch.) 893; 13 Eng. L. & Eq. 245; Smith *v.* Reese River Co., L. R. 2 Eq. 263 aff'd L. R. 4 H. L. 64; *s. c.* L. R. 2 Ch. 604; Glamorganshire Iron &c. Co. *v.* Irvine, 4 Fost. & Fin. 947, 955; Henderson *v.* Railroad Co., 17 Tex. 560; *s. c.* 67 Am. Dec. 675.

or not knowing whether they are true or false, and careless whether they are true or not, is equally fraudulent. Utter carelessness of truth, where the interests of others are concerned, is evidence of fraud. And it is for the jury to consider whether statements in the prospectus, proved to have been untrue in fact, were put forth carefully or recklessly, with the intention of influencing, and thus misleading, others; or honestly, and in the fair and reasonable belief in their truth." [1] That there should be two rules on the subject of what is honest and what is dishonest is a reproach to any system of jurisprudence. This is especially so in those States where the two systems, known respectively as law and equity, have been blended in the modern codes of procedure. For judges working under such a system to hold that honesty or dishonesty depends upon the *form of action* is a gross imputation upon them; and yet there are many such decisions, as is well known. In the absence of *laches* or special circumstances, the same rule ought to apply whether the shareholder is proceeding to obtain a rescission of his contract on the ground of fraud, or whether he is defending on this ground against an action by the corporation to enforce it. This is especially true under those codes of procedure which permit equitable defenses in actions for calls. The rule laid down by the Court of Appeals of Virginia ought not to be subject to doubt anywhere, — *that* if in written proposals for a sale of stock in a company, representations are contained false as to any material fact, by which the purchasers have been misled to their injury, and in which they are presumed to have trusted to the vendors, then the contract founded upon such representations is void whether the vendors knew the representations to be false at the time they were made or not, and whether made with a fraudulent intent or not.[2]

§ 1389. Except where the Action is for Deceit Against the Persons Committing the Fraud. — An exception to this rule exists in those cases where an action, either at law or in equity,

[1] Glamorganshire Iron Co. *v.* Irvine, 4 Fost. & Fin. 947, 955.

[2] Crump *v.* United States Mining Co., 7 Gratt. 353; *s. c.* 56 Am. Dec. 116. The court used the word "void" in the sense of voidable. See also Directors &c. *v.* Kisch, L. R. 2 H. L. 99.

is brought against those persons who are alleged to have committed the fraud. It would be obviously unjust to charge them with personal responsibility for a constructive fraud, not intended by them, — the company, not they, receiving and retaining the proceeds. In such cases, it is necessary to fix them with *guilty knowledge* of the misrepresentations or concealments which induced the plaintiff to enter into the contract, — with what, in an action of deceit, is technically called a *scienter*.[1] This is well illustrated by an English case, where brokers, employed by the directors of a corporation to place its debentures on the market, issued a false and fraudulent prospectus, bearing the names of the defendants, which deceived the plaintiff into purchasing certain of the debentures, which turned out to be worthless. The directors having been guilty of no personal fraud, it was held that the plaintiff could not recover damages of them. The principle that one cannot retain money which he has obtained through fraud did not apply, because the directors had not obtained the money; it had gone to the corporation. Nor could the action be sustained upon the rule which makes the principal responsible for the fraud of his agent, for the defendants were not the principals of the brokers: the corporation was.[2] The distinction so clearly pointed out in this case, between the case where the individual making the misrepresentation *gets the benefit* of the contract and the cases where he does not, is constantly overlooked by the courts. But in the particular case the directors, being shareholders, got the benefit in common with the other shareholders; and herein lies an infirmity in the reasoning.

§ 1390. Distinction between Fraud and Failure of Consideration. — There is an important difference between cases where a contract may be rescinded on the ground of fraud and those in which it may be rescinded on the ground that there is a difference between the thing obtained and the thing bargained for. This principle is quite extensive. If a person sells a bill of exchange which turns out to be forged, or invalid under the stamp laws, he must, on this principle, restore to the purchaser

[1] Henderson *v.* Lacon, L. R. 5 Eq. 249, 262; Craig *v.* Phillips, 3 Ch. Div. 722, 737.

[2] Weir *v.* Bell, 3 Exch. Div. 238.

the money received, although he was entirely innocent in making the sale.[1] So, as held in a numerous class of English cases, if a person subscribes for shares in a projected corporation on the faith of certain statements made in a prospectus, and, on inspecting the memorandum of association, finds that the undertaking is substantially different from that represented by the prospectus, he is entitled to a rescission of his contract of subscription, on the principal ground that the company do not propose to give him that which he agreed to take: he subscribed for shares in one kind of a venture, and they tender him shares in another.[2] But the variance must be substantial; a mere difference of expression in the two instruments will not have this effect. The obligations incurred in the memorandum must substantially differ from those represented in the prospectus.[3] So, an innocent misrepresentation does not authorize a rescission, unless it is such as to show that there is a complete difference, in substance, between what was supposed to be and what was taken, so as to constitute a failure of consideration. This principle was stated and applied in a case where it appeared that a mail-steamship company issued, in good faith, a prospectus for additional shares to enable it to carry out a contract which it had made with the government of New Zealand for carriage of the mails, and on the faith of this, A. subscribed for shares. It turned out that the agent of the government of New Zealand had no power to make the contract in question, and a subsequent min stry repudiated it. In consequence of this the shares depreciated in value, though they still remained valuable. It was held that this was no ground for a rescission of the contract.[4] One court has reasoned that the consideration for the subscription to the stock of a railroad company is to be deemed the shares of stock, and not such collateral and incidental advantages as the subscriber may expect to obtain from the building of the road; and hence that if, by reason of the road not being built,

[1] Gompertz *v.* Bartlett, 2 El. & Bl. 849; *s. c.* 23 L. J. (Q. B.) 65; Gurney *v.* Wormersley, 4 El. & Bl. 133.

[2] Ship's Case, 2 De G, J. & S. 544; Webster's Case, L. R. 2 Eq. 844; Oakes *v.* Turquand, L. R. 2. H. L. 325; Downes *v.* Ship, L. R. 3 H. L. 343; *ante*, § 1268, *et seq.*

[3] Downes *v.* Ship, *supra.*

[4] Kennedy *v.* Panama &c. Mail Co., L. R. 2 Q. B. 579.

he does not obtain these advantages, he cannot allege a failure of the consideration of his subscription.[1] Of course, in any case, if the subscription has been obtained in good faith, the fact that it turns out to be *less valuable* than it would have been if certain things, not conditions precedent, had been done as represented, will not release the subscriber.[2]

§ 1391. **Further of this Distinction.** — But where there has been actual fraud, it is enough to show that there have been fraudulent representations as to *any part* of that which induced the party to enter into the contract which he seeks to rescind. And there is authority for saying that, where there have been fraudulent misrepresentations and concealments of material facts, the law will conclusively presume injury from the fact of the fraud. It follows, that while the subscriber will not be heard to urge a state of facts produced by his failure to comply with his contract,[3] yet where a person has been entrapped into such a contract by fraud, and defends an action for calls on this ground, it is no answer to his defense that, notwithstanding the fraud, if he will pay, his money will be so used that he will sustain no harm. The defense is complete when the fraud is shown; and it cannot be overcome by any considerations of future possible advantages to arise from the enforcement of the contract.[4]

§ 1392. **Puffing and Exaggeration.** — A mere puffing and exaggeration of the value of the property of which the company about to be organized is to become the owner will not be sufficient to avoid a contract to take shares, provided the prospectus does not contain any material misstatements of fact. For, every one who looks at the prospectus of a corporation understands that the thing is colored, in the sense that every thing is put forward in the most favorable view it can be.[5]

[1] Bish *v.* Bradford, 17 Ind. 490; Brownlee *v.* Ohio &c. R. Co., 18 Ind. 68; Parker *v.* Thomas, 19 Ind.2 13; *s. c.* 81 Am. Dec. 385.

[2] Penobscot R. Co. *v.* Dummer, 40 Me. 172; *s. c.* 63 Am. Dec. 654.

[3] Cook *v.* Whitfield, 41 Miss. 541. And see Morrison *v.* Ives, 4 Smedes & M. (Miss.) 652.

[4] Water Valley *v.* Seaman, 53 Miss. 655, opinion by Chalmers, J.

[5] Kisch *v.* Central Railroad of Venezuela, 34 L. J. (Ch.) 545, per Turner, L. J ; Denton *v.* Macneil, L.

§ 1393. Fraudulent Promise of Something Unlawful — Ignorance of Law. — The case against the stockholder becomes stronger where the fraudulent inducement on the faith of which he consented to subscribe consisted of a promise to do something which the corporation could not lawfully perform. Such a representation is one on which the party has no right, in any event, to rely; and if he does so, it is his own folly, from the consequences of which the law will not relieve him;[1] since every one is held bound to know the law, — a principle which prevails in courts of equity as well as in those of common law.[2] "The law," said Mr. Justice Hunt, in the first case, "is presumed to be equally within the knowledge of all parties. That a stockholder may relieve himself from his contract by proof that he was misinformed as to the effect of his contract when he made it, would be a disastrous doctrine. That a defendant who could not, by contract, lawfully relieve himself from liability as a stockholder can accomplish that result by proof that it was fraudulently represented to him that he could so relieve himself, would be strange indeed."[3] On this ground it was held that a fraudulent representation that the shares were *non-assessable* was no defense as against creditors.[4] We have already seen that the *charter* of the corporation is deemed to enter into and to form a part of the contract.[5] On this ground it has been held that false

R. 2 Eq. 350. "Expressions of opinion, commendation of the subject of the contract, statements as to productiveness and value, are no grounds for setting a sale aside, although they are shown to be false." This rule was applied in a case where the action was on a promissory note given for corporate shares, and where the defense was fraudulent representations in respect of the condition of the corporation. Union Nat. Bank *v.* Hunt, 76 Mo. 439, 445; affirming on this point *s. c.* 7 Mo. App. 42, 49. See also Gordon *v.* Parmelee, 2 Allen (Mass.), 213; Brown *v.* Castles, 11 Cush. (Mass.) 350. The folly of placing reliance on the statements of the agents sent out to procure subscriptions to shares of corporate stock is illustrated by the case of Thornburg *v.* Newcastle &c. R. Co., 14 Ind. 499, as well as by those cited in the next section.

[1] Upton *v.* Tribilcock, 91 U. S. 50; Johnson *v.* Crawfordsville &c. R. Co., 11 Ind. 280; Parker *v.* Thomas, 19 Ind. 213; *s. c.* 81 Am. Dec. 385.

[2] Upton *v.* Tribilcock, 91 U. S. 50; Bank of United States *v.* Daniel, 12 Pet. (U. S.) 132; Hunt *v.* Rousmaniere's Administrator, 1 Pet. (U. S.) 1; Mellish *v.* Robertson, 25 Vt. 603; Leavit *v.* Palmer, 3 N. Y. 19.

[3] Upton *v.* Tribilcock, 91 U. S. 50.

[4] *Ibid.*

[5] *Ante*, § 1137.

representations by the commissioners as to matters fixed by the charter are not available as a defense to an action for assessments, — the court saying: "The duties and powers of the commissioners were prescribed by the charter. They had no power to locate the road, but its location depended upon the will of the president and directors when the company was organized. The subscribers must be presumed to have known the provisions of the charter, and, knowing them, they could not have been deceived or misled by any representations made to them on this subject by the commissioners." [1] On this theory it has been reasoned that representations by an agent sent out to solicit stock subscriptions that the proposed railroad would be aided by another, would not be available to avoid the contract of subscription on the ground of fraud, since such representations involved the question of the corporate power of that other.[2] There is technical propriety, but often gross injustice, in the rule which holds an ignorant man to a knowledge of the statute law, which even the lawyers and judges do not understand; and the sounder and juster conception is that if the corporation, in order to obtain the stock subscription promises something which is unlawful, and which it hence cannot perform, there is no contract.[3]

§ 1394. **Statements as to Matters of Opinion, Belief, and Motive.** — Upon the same ground rest parol statements of matters of opinion, intention and belief,[4] such as the time within which the proposed railroad will be built;[5] the probable expense

[1] Wight *v.* Shelby R. Co., 16 B. Monr. (Ky.) 4; *s. c.* 63 Am. Dec. 522. Compare *ante*, § 1308, *et seq.*

[2] Johnson *v.* Crawfordsville &c. R. Co., 11 Ind. 280.

[3] This is illustrated by a recent case in New York where, in order to induce persons to subscribe, a corporation offered its stock at 30 per cent. less than its par value. It was held, under the laws of N. Y. 1848, c. 40, § 10, providing that the capital stock "shall all be paid in, one-half thereof within one year, and the other half thereof within two years from the incorporation of said company, or such corporation shall be dissolved," that the scheme, and contracts of subscription founded on it, were *ultra vires* and not enforceable. Zelaya Min. Co. *v.* Meyer, 8 N. Y. Supp. 487.

[4] Armstrong *v.* Karshner, 47 Ohio State, 276; *s. c.* 24 N. E. Rep. 897.

[5] Brownlee *v.* Ohio &c. R. Co., 18 Ind. 68; Hardy *v.* Merriweather, 14 *Id.* 203; Parker *v.* Thomas, 19 *Id.* 213, 219; Walker *v.* Mobile &c. R. Co., 34 Miss. 245. This application of the rule is forcibly denied in a Texas case. Henderson *v.* Railroad Co., 17 Tex. 560, 569; *s. c.* 67 Am. Dec. 675.

of the improvement undertaken by the corporation;[1] the prospective value of its stock;[2] the profits to be derived from it, and the amount which the subscribers will be required to pay in;[3] things to be done in the future by some other person or corporation, as that another corporation will aid the one which is being organized;[4] and parol representations that the person proposing to equip the railroad of the proposed company is able to do it without any advance from the company;[5] or that the company has stock enough to fit out the road in a given length of time,[6] and only desires the defendant's subscription, and that of others along the line of the road, as an evidence of their friendly disposition towards the road.[7] So, where a prospectus stated that a certain invention, which it was the object of the company to work, had been tested, and that, according to the experiments, the material could be produced at a certain specified cost, but that it was the intention to test the invention further, and, after some further testing, the invention turned out to be worthless, it was held that this was not such a misrepresentation as would avoid the contract.[8] The distinction has already been made sufficiently clear.[9] In order to avoid a contract of subscription, it must appear to have been made upon the faith of false representations in regard to a matter of fact material to the success of the enterprise. The mere holding out, by an agent, of flattering prospects is no ground for avoidance.[10] And where the prospectus mentioned several pieces of property which the company was to purchase for the prosecution of the enterprise, the fact that the company failed to acquire one of these pieces (a very inconsiderable portion in proportion to the whole), through defect in the title thereto, was not a circumstance suffi-

[1] Crossman *v.* Penrose &c. Co., 26 Pa. St. 69.

[2] Vawter *v.* Ohio &c. R. Co., 14 Ind. 174.

[3] Walker *v.* Mobile &c. R. Co., 34 Miss. 245.

[4] Johnson *v.* Crawfordsville &c. R. Co., 11 Ind. 280, 285.

[5] Andrews *v.* Ohio &c. R. Co., 14 Ind. 169.

[6] Hardy *v.* Merriweather, 14 Ind. 303; Bish *v.* Bradford, 17 *Id.* 491; Dynes *v.* Shaffer, 19 *Id.* 165.

[7] Bish *v.* Bradford, *supra.*

[8] Denton *v.* Macneil, L. R. 2 Eq. 350. See further, as to misrepresentation of matters of intention, McAllister *v.* Indianapolis &c. R. Co., 15 Ind. 11.

[9] *Ante,* § 1384.

[10] Hughes *v.* Antietam Man. Co., 34 Md. 316.

cient to invalidate a subscription made on the faith of such prospectus, in the absence of fraud or misrepresentation.[1]

§ 1395. **Parol Representations Varying Written Contract.** — On familiar grounds, parol representations made for the purpose of inducing a person to take shares in the stock of a company, cannot be urged in avoidance of the contract, where such representations varied or contradicted the terms of the contract itself.[2] Thus, a representation that the proposed railroad will be built to a certain point,[3] the agreement of subscription stating otherwise, or leaving it in the discretion of the directors whether it should be built to that point or not;[4] or that the subscriber might pay for his subscription in ties at a certain rate,[5] or in lands or labor,[6] the contract itself calling for payment in cash, — will not relieve the subscriber. The Supreme Court of Arkansas has gone so far in this direction as to hold that, where the subscription was general and unconditional, declarations made by the president of the company, in speeches made by him to induce people to subscribe for shares, as to the location of the road, could not be proved as a defense in an action for calls, unless the substance of such declarations had been incorporated into the contract of subscription, and a compliance therewith by the corporation made a condition precedent to the payment of

[1] Kelsey *v.* Northern Light Oil Co., 54 Barb. (N. Y.) 111.

[2] *Ante*, §§ 1311, 1315; Vicksburg, &c. R. Co. *v.* McKean, 12 La. An. 638; East Tennessee &c. R. Co. *v.* Gammon, 5 Sneed (Tenn.), 567; Connecticut &c. R. Co. *v.* Bailey, 24 Vt. 465; *s. c.* 58 Am. Dec. 181; North Carolina R. Co. *v.* Leach, 4 Jones L. (N. C.) 340; Martin *v.* Pensacola R. Co., 8 Fla. 370; *s. c.* 73 Am. Dec. 713; Piscataqua Ferry Co. *v.* Jones, 39 N. H. 491; Smith *v.* Tallahassee Plank Rd. Co., 30 Ala. 650; Mississippi &c. R. Co. *v.* Cross, 20 Ark. 443, 454; Ogilvie *v.* Knox &c., 22 How. (U. S.) 380; Andrews *v.* Ohio &c. R. Co., 14 Ind. 169; McAllister *v.* Indianapolis &c. R. Co., 15 Ind. 11; Goodrich *v.* Reynolds, 31 Ill. 490; *s. c.* 83 Am. Dec. 240; Vawtor *v.* Miss. R. Co. 41 Ind. 174; Salem Mill Dam. Corp. *v.* Ropes, 9 Pick. (Mass.) 187; *s. c.* 19 Am. Dec. 363; Evansville &c. R. *v.* Posey, 12 Ind. 363; Eakright *v.* Logansport &c. 13 *Id.* 404; Carlyle *v.* Evansville &c. R. Co. 13 Ind. 477.

[3] Evansville &c. R. Co. *v.* Posey, 12 Ind. 363.

[4] Johnson *v.* Crawfordsville &c. R. Co., 11 Ind. 280, 284; Miller *v.* Hanover Junction R. Co., 87 Pa. St. 95; *s. c.* 30 Am. Rep. 349; Compare Hester *v.* Memphis &c. R. Co., 32 Miss. 378.

[5] Thornburgh *v.* Newcastle &c. R. Co., 14 Ind. 499.

[6] Walker *v.* Mobile &c. R. Co., 34 Miss. 246.

assessments upon the stock.[1] In like manner, the Supreme Court of Indiana has held that a parol representation that a proposed railroad would be built to a certain point, which representation was not made good, was no defense to an action for calls, where the contract of subscription was an absolute one.[2] In another case the same court places its conclusion on this point, on the ground that, the subscription being absolute on its face, the legal effect of it is that the consideration for the promise is the shares of stock in the company, for which he subscribes; and hence the verbal representations of the agent procuring it must be held mere expressions of opinion.[3] This doctrine cannot be sound. Applied generally, it would give an absolute immortality to fraud; since no person entrapped into a written contract by verbal misrepresentations could avoid it unless the misrepresentations were embodied in the contract. Such, as is well known, is not the law; although there may be ground for a distinction between misrepresentations contained in a prospectus in writing, deliberately put forth by the directors of the company, and misrepresentations made, or alleged to have been made, by parol, on which the subscriber had no right to rely, just as there is between verbal slanders and written libels.

§ 1396. **Further of this Subject.** — A writer of reputation on railroad law says, referring to this subject: "A provision as to the location, so as to be binding on the company and render the subscription conditional, must be inserted in the agreement * * * A subscriber cannot defend a suit for the calls by parol proof that he should not have become a party to the agreement unless he had supposed a particular route would be adopted;" that "representations of a class of officers with whom the power of location is not lodged will not bind the company;" and that "even the representations of those who have this power are mere matters of opinion, on which he has no right to rely."[4] So, if A. tells the agent sent out by the corporation to procure subscriptions, that he will not subscribe unless B. sub-

[1] Mississippi &c. R. Co. *v.* Cross, 20 Ark. 443.

[2] Evansville &c. R. Co. *v.* Posey, 12 Ind. 363.

[3] Eakright *v.* Logansport &c. R. Co., 13 Ind. 404, 410. And see Carlisle *v.* Evansville &c. R. Co., *Id.* 477.

[4] Pierce Am. Rail. Law, 72. To this effect see Clem *v.* Newcastle &c. R. Co., 9 Ind. 488; New Albany &c. R.

scribes, and the agent thereupon enters B.'s name as a subscriber, B. being a relative of such agent, and he being honestly of opinion that B. intends to become a subscriber, by which means he procures the subscription of A., this will not invalidate the contract, because the condition that B. should become a subscriber was not a part of the written contract.[1] It has been also reasoned that a subscriber has no right to rely on the representations of the soliciting agent as to what the agreement to be subscribed to contains, and therefore he cannot rely upon the falsity of such representations as a defense to a suit on his subscriptions;[2] but the writer assumes the rule to be otherwise in a supposed case where such misrepresentations are made *to an illiterate person*.[3] An authoritative court has taken the strange position that fraudulent representations made in the most public manner and with the apparent sanction of a majority of the directors of the corporation, will not avoid a subscription, on the ground that liability for fraud rests on the rule of *respondeat superior*, and that unless authority has been conferred by the directors, *acting as a board*, to make the fraudulent representations, it is not available to rescind the contract, but the corporation can keep the fruits of the fraud.[4] The fraudulent representation in question was made by a director at a public meeting and in the presence of the president of the company. The fallacy and injustice of this holding rest in the fact that the liability of a corporation for frauds and for all other torts does not rest at all on the rule of *respondeat superior;* — otherwise they never could be held liable for wrong-doing, as they can only act through agents, and have no power to authorize their agents to do wrong.[5]

§ 1397. Ambiguous Statements. — A representation in the prospectus of a company will not have the effect of avoiding a

Co. *v.* Fields, 10 *Id.* 187; North Carolina R. Co. *v.* Leach, 4 Jones L. (N. C.) 340; *Ante*, § 1311.

[1] Cunningham *v.* Edgefield &c. R. Co., 2 Head (Tenn.), 23. But see Center Turnpike Co. *v.* McConaby, 16 Serg. & R. (Pa.) 140.

[2] Thornburgh *v.* Newcastle &c. R. Co., 14 Ind. 499.

[3] *Ante*, § 1308.

[4] Buffalo &c. R. Co. *v.* Dudley, 14 N. Y. 336. That this was the primitive conception on this subject, see *post*, Chs. 138, 139.

[5] *Post*, Ch. 138.

contract to take shares, merely because its language, in stating a given fact, is ambiguous, so that the representations, *as interpreted by the subscriber*, are untrue. In order to have this effect, the language used must be clear and unequivocal, and susceptible of but one meaning, which meaning must be a misrepresentation of material facts. When, therefore, a prospectus stated that the company would commence operations with six screw steamships of a certain description and referred the public to the articles of association for furthur particulars, and the company had, at the time the prospectus was issued, no steamships, but afterwards purchased some, not however of the description mentioned in the prospectus, it was held by Lord Chelmsford, L. C., that the statement was not a clear misrepresentation, but an ambiguity, which, in view of the fact that the means of ascertaining the truth were open to the subscriber, would not entitle him to a rescission of the contract.[1]

§ 1398. **Misstatements as to the Names of Directors.**— The character of the directors of a proposed company is, as is well known, a very important element in any calculation as to its probable success. If the men who are to head the concern are men of probity, ability, and financial standing, it will, other things being equal, command the public confidence. This being so, it is the practice of many promoters of companies to induce men of this reputation to consent to serve in the directory, on the promise that the shares necessary to qualify them for this office shall be paid for by others; that their duties shall be nominal merely; and sometimes, that they shall not only be guaranteed against liability on account of being members of the concern, but that they shall receive compensation for so acting. Such arrangements are a fraud upon the public, and, upon sound principles, ought to afford a ground upon which any person deceived by them into subscribing to the shares of the company might claim a rescission; and it has been so held.[2] But the fact

[1] Hallows *v.* Fernie, L. R. 3 Ch. 467; affirming *s. c.* L. R. 3 Eq. 520.

[2] Blake's Case, 34 Beav. 639, Sir John Romilly, M. R., saying: "It is obvious that a more gross misrepresentation can hardly be made, than holding out to the world that responsible persons who have nothing at all to do with the company are directors of it."

that one of the persons named in the prospectus of the company as a director, after consenting to act as such, and attending one meeting, retires from the board, in the absence of proof that his name was used as a decoy, affords no ground for rescinding a contract to take shares.[1]

§ 1399. **Fraud in which the Subscriber Seeking Relief Participated.**—If the shareholder who seeks relief from his contract on the ground of fraud, himself knowingly participated in organizing the company and in putting forth the fraudulent representations, he will of course be estopped by his own conduct from claiming a rescission; since no person can have any standing in a court of equity who does not come with clean hands, and no person is permitted in any court to derive an advantage from his own wrong.[2]

§ 1400. **Such as Secret Agreements with Shareholders Prejudicial to the Corporation.** — Hence it will be no defense that the *subscription was colorable* merely, not intended to be paid, and that there was a secret agreement that it should not be paid, but that it was intended merely to enable the corporation to get sufficient stock subscribed to enable it to become incorporated under the law,[3] or to induce others to subscribe for shares,[4] or to give credit to the concern.[5] The rule extends so far as to avoid all secret conditions[6] annexed to the contract of particular subscribers by which their engagement is rendered more onerous to the corporation, more favorable to them, or in any respect *different* from that named in the written contract and in the governing statute; and to hold the subscriber liable to the obligations of a *bona fide* shareholder; and this is illustrated by a

[1] Hallows *v.* Fernie, L. R. 3 Ch. 467; affirming *s. c.* L. R. 3 Eq. 520.

[2] Litchfield Bank *v.* Church, 29 Conn. 137, 150; Southern Plank Rd. Co. *v.* Hixon, 5 Ind. 165, 169; Center Turnpike Co. *v.* McConaby, 16 Serg. & R. (Pa.) 140.

[3] Litchfield Bank *v.* Church, 29 Conn. 127, 150, and Center Turnpike Co. *v.* McConaby, 16 Serg. & R. (Pa.) 140; Graff *v.* Pittsburgh &c. R. Co., 31 Pa. St. 487, 489.

[4] White Mountains R. Co. *v.* Eastman, 34 N. H. 134; Custar *v.* Titusville Gas Co., 63 Pa. St. 381, 386. See Miller *v.* Hanover Junction R. Co., 87 Pa. St. 95; *s. c.* 30 Am. Rep. 349.

[5] Litchfield Bank *v.* Church, *supra.*

[6] *Ante*, § 1311.

variety of decisions cited here and elsewhere.[1] Of this nature is a private agreement with the directors that the subscribers are to be allowed to make part *payment in work*.[2] Nor will *equity reform* a contract of subscription to the capital stock of a corporation by inserting therein a contemporaneous parol agreement making the subscription *conditional* upon the corporation doing a certain thing, such as locating its railroad on a particular route.[3] Nor can such an agreement be set up as a defense under a plea of *failure of consideration;* for while it is competent to show by extrinsic evidence the absence, failure, or illegality of a contract in writing, or that the consideration is greater or less than that specified, yet it is not competent to show a consideration adverse to the one expressed on the face of the instrument.[4] "There is reason for this principle. A subscription to a joint stock is not only an undertaking to the company, but with all other subscribers. Such contracts are trilateral; and, even if fraudulent as between two of the parties, they are to be enforced for the benefit of the third." [5] "In all such undertakings," said Ewing, J., "the respective subscriptions are contributions

[1] Saffold *v.* Barnes, 39 Miss. 399; New Albany R. Co. *v.* Fields, 10 Ind. 187; New Albany R. Co. *v.* Slaughter, 10 Ind. 218; Robinson *v.* Pittsburgh &c. R. Co., 32 Pa. St. 334; *s. c.* 72 Am. Dec. 792; Downey *v.* White, 12 Wis. 176; *s. c.* 78 Am. Dec. 731; Chouteau Ins. Co. *v.* Floyd, 74 Mo. 286, 290; Blodgett *v.* Morrill, 20 Vt. 509; Mann *v.* Cooke, 20 Conn. 179, 187. Where representations made by an agent, to obtain subscriptions, are a part of a scheme of fraud participated in by the officers authorized to manage its affairs, or where they are such as the agent may reasonably be presumed by the subscriber to have the authority of the corporation to make, his representations may be given in *evidence* to show the fraud by means of which the subscription was procured. A representation by an agent that he will *release* a subscription that he is taking does not afford a presumption of such authority. Custer *v.* Titusville &c. Co., 63 Pa. St. 381; Saffold *v.* Barnes, 39 Miss. 399; Litchfield Bank *v.* Church, 29 Conn. 137.

[2] Ridgefield &c. R. Co., *v.* Brush, 43 Conn. 86.

[3] Gelpcke *v.* Blake, 15 Iowa, 387; *s. c.* 83 Am. Dec. 418.

[4] Gelpcke *v.* Blake, 19 Iowa, 263.

[5] Woodward, J., in Graff *v.* Pittsburgh, &c. Co., 31 Pa. St. 489, 498; Gordon, J., in Miller *v.* Hanover &c. R. Co., 87 *Id.* 95, 99; *s. c.* 30 Am. Rep. 349. The author has (*ante*, § 1308) ventured the opinion that this view is unsound. In the case of a composition between a debtor and his creditors, which is a "trilateral" contract, if that word may be used, the rule is exactly the reverse: a fraudulent connivance between the debtor and a single creditor releases them all. Bank of Commerce *v.* Hoeber, 11 Mo. App. 475; *s. c.* aff'd, 88 Mo. 37.

for a common object, in which each stockholder invests his money upon the faith of a like investment by the others, and especially in the confidence that the engagements and liabilities of each subscriber are what they purport to be. The assurance others held out of a common participation in the burdens no less than the benefits, is among the chief inducements. It is evident, from this view of the relation that stockholders sustain to each other, that to give effect to an agreement like that relied on as a defense in this case would be a fraud upon the other subscribers; that it would sanction the principle that, by a secret stipulation entered into between these parties, they could so modify the contract as to relieve the defendant from a liability which the other subscribers believed he had really assumed, and also of his due share of the burden which he ostensibly took upon himself by the contract to which he and they in common became parties."[1]

§ **1401. Illustrations of the Foregoing.**— This is well illustrated by a case where a subscriber to the stock of a plank road association made his subscription upon the faith of an agreement or representation by the corporator, who induced him to make it, that he would not be required to pay the amount subscribed unless the road should be built. It was held in such an action that this secret agreement was void.[2] - - - - It is also well illustrated by a case in Connecticut, where a bank was fraudulently gotten up, under a lawful charter, by persons who induced the defendant to subscribe for a portion of the stock, representing to him that his subscription would be merely nominal, and that he would not be required to pay for the stock. The bank was organized, issued a large amount of bills, and soon after failed and passed into the hands of receivers. In a suit brought by the receivers in the name of the bank against the defendant, on his subscription, it was held that he could not avail himself, in defense of the fraudulent character of the bank, or of the misrepresentations under which he had been induced to subscribe for the stock. He, with his associates, constituted the bank, and he therefore shared with them in the fraud of the bank on the public.[3] - - - - The same court, however, held that this doctrine did not apply in a suit by a receiver of the same bank against one who had given his note to the bank for five

[1] La Grange &c. Plank Road Co. *v.* Mays, 29 Mo. 64, 66.

[2] La Grange &c. Plank Road Co. *v.* Mays, 29 Mo. 64, 66.

[3] Litchfield Bank *v.* Church, 29 Conn. 137.

shares of its stock, transferred to him under an arrangement with the bank, soon after its organization, by one of the original subscribers to its stock. He did not stand on the footing of the original corporators, who had participated in the scheme of fraud under which the bank was organized, but in the relation of a third person defrauded by them, and he could set up, even as against the receiver, the fraudulent representations by which he was induced to give the note.[1] - - - - This is also illustrated by a case where the directors of an insurance company agreed among themselves to take a majority of the stock, and to give their stock-notes for the same, secured by an hypothecation of the stock; and, after the company had become greatly embarrassed, one of the directors agreed with the president to give him $6,000 if he would take his stock and substitute his own note in lieu of the stock-note of such director, which was done accordingly. This the court held to be a fraud upon the creditors of the company and the other stockholders who had paid for their stock, and that the receiver who had been appointed to wind up the affairs of the company was entitled to recover the amount of the stock-note of the director, thus given up, with the exception of the sum which had actually been paid by the president to the company out of the $6,000 received by him as a premium upon his purchase.[2] - - - - To induce a plaintiff to sign a subscription paper, whereby he and others agreed to pay the sums set against their names for the purpose of purchasing property of a mining company, the defendant, the promoter of the scheme, secretly agreed to give plaintiff on behalf of the corporation, a certain number of shares, "above his subscription free of cost on placement of property," in consideration of the use of plaintiff's name as an inducement to other persons to sign; and some did sign the subscription paper in ignorance of the secret agreement, and influenced more or less by the fact that plaintiff had signed it. Subsequently, the agreement not having been signed by the requisite number of subscribers, it was abandoned, and a new agreement was proposed between the subscribers and the company, by which they should purchase stock of the company at a certain price, into which the plaintiff refused to enter unless the company would carry out the original arrangement with him for additional shares free, to which defendant agreed; and the new agreement was carried out, plaintiff acting with the other subscribers, apparently upon an equality with them, and intending that his subscription should be used to secure that result. It was held that evidence of these facts was admissible, in an action by plaintiff to recover from defendant the

[1] Litchfield Bank v. Peck, 29 Conn. 384.

[2] Nathan v. Whitlock, 9 Paige (N. Y.), 152.

value of the stock secretly bargained for, to sustain the defense that the agreement was illegal and void, as a fraud upon other purchasers of the stock.[1] - - - - So, where a person subscribed to the building of a railroad according to a specified survey, the amount to be paid only when the subscriptions should reach a specified amount, it was held that he could not be permitted to show, in an action by the corporation for an assessment upon his shares, that he had been induced to subscribe by promises of the company's agent that the road should be constructed, not according to the survey, but past his house, etc., and that his subscription was not to be binding unless the road was so constructed.[2] - - - - In a subsequent case, in the same State, this case is distinguished and its authority weakened, by holding that "after the organization of the company a condition is binding; and ordinarily this is so, though it rest in parol only, where, except for such condition, the subscription would not have been made, and provided the 'rights of co-subscribers are not affected thereby. So, where, previous to signing a subscription to stock in a corporation, the defendant objected to signing, for the reason that certain conditions, on which the subscription was being made, did not appear thereon, and was assured by the president of the corporation that these conditions would be considered as a part of the contract, parol evidence of these conditions was held admissible in a suit on the subscription and the non-performance of them is a defense.[3]

§ 1402. But Such Agreements Good Between Shareholders. — But such agreements are valid and enforceable as between the shareholders who make them. An agreement by one who subscribes to the stock of a corporation and other shareholders who hold a majority of its stock and have consequently a controlling interest in it, that the latter will, after the lapse of a given time, if the subscriber shall desire to sell his shares, purchase them from him at the price at which he buys them from the corporation with lawful interest, is a valid and enforceable contract. It is reasoned that it does not fall within the reasons which discharge secret agreements between corporations and in-

[1] Nickerson *v.* English, 142 Mass. 267; *s. c.* 8 N. E. Rep. 45; 2 New Eng. Rep. 662; 6 East. Rep. 651.

[2] Miller *v.* Hanover Junction &c. R. Co., 87 Pa. St. 95; *s. c.* 30 Am. Rep. 349.

[3] McCarty *v.* Sellinsgrove &c. R. Co., 87 Pa. St. 332. This last case seems not only directly opposed to the preceding case, but to the whole current of authority. *Ante*, §§ 1311, 1315.

tending subscribers to their shares and which enforce the contract of subscription according to its ostensible terms. Nor does it fall within the reasons which discharge secret collateral agreements in a contract of composition between a debtor and his creditors by which a particular creditor gets an advantage in the distribution of the assets of the insolvent over his other creditors.[1] But it rests on the plain principle that it is perfectly competent for those who hold a controlling amount of the shares of a corporation and who desire to effect sales of their shares for the purpose of adding to the working capital of the company, to agree with outside parties that if, after purchasing such shares and holding them for a given time, they shall become dissatisfied with their bargain, the undertakers will take the bargain off their hands.[2] A recent case in Illinois holds that one who subscribes to the capital stock of a corporation solely in order to enable it to obtain a certificate of organization, under an agreement with the other subscribers that he is not to be liable on the stock, and is not to be required to pay assessments thereon, is *not liable to an assessment* on such stock in favor of other subscribers, though he will be liable in favor of creditors when it becomes necessary to assess it in order to pay debts of the corporation.[3]

§ **1403. Application of this Rule in Case of Registered Companies.** — This doctrine acquires additional force in case of a corporation organized under a general law which requires the *public recordation* of a certificate showing the capital stock subscribed, the amount paid in, to whom paid, the value of the shares into which the stock is divided, the residence of the sub-

[1] In illustration of this principle in relation to compositions with creditors, see White *v.* Kuntz, 107 N. Y. 518. That such an agreement avoids the whole composition deed, see Bank of Commerce *v.* Hoeber, 11 Mo. App. 475; *s. c.* affirmed, 88 Mo. 37; *s. c.* on former appeal, 8 Mo. App. 171; Luehrmann *v.* Furniture Co., 21 Mo. App. 503; Knight *v.* Hunt, 5 Bing. 429; *s. c.* 3 M. & P. 18; Solinger *v.* Earle, 82 N. Y. 393; Brock *v.* Cole, 4 Sandf. (N. Y.) 79; Re Whitney, 14 Nat. Bank Reg. 3; Re Sawyer, 14 Nat. Bank Reg. 241. See also, as illustrating the exact good faith required in composition agreements, Russell *v.* Rogers, 10 Wend. (N. Y.) 474; *s. c.* 25 Am. Dec. 574; Leicester *v.* Rose, 4 East, 372.

[2] Meyer *v.* Blair, 109 N. Y. 600; *s. c.* 4 Am. St. Rep. 500. See *ante*, § 1312.

[3] Winston *v.* Dorsett &c. Co., 129 Ill. 64; *s. c.* *sub nom.* Winston *v.* Brooks, 21 N. E. 514. Compare Re Central Bank, 25 Can. L. J. (N. S.) 238.

scribers, and the number of shares by each subscribed; and no reason is perceived why the same rule should not have obtained under the English Companies Acts, which contain provisions for the public registration of a similar memorandum of association. The obvious purpose of such statutory provisions is to compel a corporation, before it can commence to do business as such, to advertise to the public those facts which show the amount of confidence which may be reposed in the concern, and the security to which the public may look in giving it credit. This being so, the familiar rules which have grown up in the American courts in giving effect to other registration laws are of obvious application here. The creditor is entitled to confide in the truth of the registered memorandum. Those who have suffered themselves to be thus, by a solemn and public act, held out as shareholders are estopped, as against the public, to deny the existence of that relation. Nor can the rights of creditors be affected by any undisclosed agreement between the corporation and its shareholders at variance with the terms of this recorded declaration. Any other rule would convert such statute into a snare, instead of a protection to the public.[1] Thus, where the registered certificate showed that a given amount of stock had been subscribed for, of which a given sum remained unpaid, it was no defense for stockholders, in an action against them by creditors, to show that this unpaid balance represented stock subscribed for by them as agents of the corporation, to be sold by the company when in need of funds.[2] So, where the stockholders of the company sued, represented one-third of a larger company, whose property and stock had been divided into three portions, the defendants taking one-third of the original stock as the capital of their new organization, the certificate thereof, setting forth the reduction of the capital stock, and that so much was paid, leaving a balance unpaid, could not be contradicted by showing that the stock was all paid; nor did knowledge by the plaintiffs of the division of the original company prevent them from recovering from the defendants for the full amount of stock unpaid, after failure to recover from the company of which they were members.[3]

[1] Allibone v. Hager, 46 Pa. St. 48.

[2] *Ibid.*

[3] *Ibid.*

§ 1404. Fraudulent Agreements with Previous Subscribers. — It has been held that a shareholder can not, in an action for assessments, set up as a defense the fact of fraudulent agreements having been made on behalf of the corporation with previous subscribers to its stock, whereby their subscriptions were to be regarded as fictitious for the purpose of inducing others to subscribe. The reason of the decision was that the law would disregard such private arrangements in respect of the previous subscribers, and would hold them to their subscriptions according to their terms; so that, whatever fraudulent arrangements may have been entered into between them and those representing the corporation, such arrangements, being futile, could work no fraud upon subsequent subscribers.[1] Similarly, another court has held that it is no defense to such an action that, when the defendant's subscription for stock in respect of which he was sued was made, the agent of the plaintiff corporation who procured it exhibited to the defendant a list of the subscribers for the corporate stock, some of whom were persons in whose judgment the defendant had confidence, and that, relying upon the representation of said agent that such persons had so subscribed for the stock, the defendant was induced to subscribe for the same; whereas the said persons were not in fact *bona fide* subscribers for the stock.[2]

§ 1405. No Defense Unless Subscriber was Misled by such Fraud. — Such a defense would be unavailing, even where the fictitious arrangement with the prior subscribers had been carried out by the corporation, unless the subsequent subscriber could make it appear that he had in fact been misled by the previous fraud, — in other words, that he had been induced to sign the subscription paper on the faith of the previous signers being bound, according to its terms. One court, in so holding, has gone so far as to say that "the defendant's subscription paper was an *independent contract*, in no way connected with the others, and from which no matter could arise creating an inducement operating upon the defendant, which in law will enable him to avoid his subscription. He has no more reason to complain than any

[1] Connecticut &c. R. Co. *v.* Bailey, 24 Vt. 465; *s. c.* 58 Am. Dec. 181, 188. Compare Blodgett *v.* Morrill, 20 Vt. 509.

[2] Chouteau Ins. Co. *v.* Floyd, 74 Mo. 286, 290.

purchaser of property can make complaint because similar commodities were sold to others under different arrangements from that made with him."[1] This reasoning, it is perceived, makes the right of one subscriber to be exonerated, on the ground of fraud in presenting him a subscription paper signed by a number of fictitious subscribers, to depend upon the question whether the terms of the paper created a privity of contract between him and the previous subscribers, — a gross misconception, since no privity of contract would be necessary to make it a fraud in those acting for the corporation to deceive him into subscribing by representing to him that certain other solvent and responsible parties had sufficient faith in the proposed enterprise to subscribe a given amount to its capital.

§ 1406. Subsequent Fraudulent Alteration of Subscription Paper. — It has been held that if one having possession of a paper containing an agreement to take shares in the capital stock of a corporation, after subscribing in good faith for shares of such stock, induces others to subscribe on the faith of his subscription, and then alters the paper by reducing the number of shares taken by himself, and delivers the instrument in this condition to the secretary, who is also a director of the company, — this will not affect the liability of one thus induced to subscribe, although at the time of such delivery the person making the alteration explains the same to the secretary, who makes no objection thereto. The reason is that such an alteration, made without the consent of the other stockholders, is a mere nullity, does not release the subscriber who so attempts to secure his release, and therefore does not affect the corresponding obligations of other subscribers.[2]

§ 1407. Charter Fraudulently Procured: Corporation Illegally Organized. — On similar grounds, it has been held that a stockholder who has accepted the charter of a corporation and assisted in putting it in operation, cannot show, when proceeded against by one of its creditors, that its *charter* was *obtained by fraud*.[3] Neither can a person who assisted in the organization of the company escape liability as a subscriber for its stock, on

[1] Connecticut &c. R. Co. *v.* Bailey, 24 Vt. 465; *s. c.* 58 Am. Dec. 189.

[2] Jewett *v.* Valley R. Co., 34 Ohio St. 601. See *ante*, § 1309.

[3] Smith *v.* Heidecker, 39 Mo. 157.

the ground that the corporation was *not organized according to law.*[1]

§ 1408. Instances under the Foregoing Rules — Shareholders Released.— A company is formed to work a particular mine which it has entered into a contract to purchase. A prospectus is issued, describing the mine in favorable terms. The statements thus made turn out to be false and fraudulent, and the mine worthless. A., who has been induced by the fraudulent prospectus to purchase shares in the company, is entitled to an injunction against an action for calls, although the company has power to purchase and work other mining property.[2] But the mere fact that such a company failed to effect the purchase of all the lands which it was expected it would purchase, which failure was caused by some defect of the title to the property in question, it being of the value of about 7½ per cent. of the entire purchase, was held no ground for rescinding such a contract.[3] - - - - The promoters of an insurance company caused to be recorded articles of association, which stated that the capital stock was $100,000; that all the stock had been subscribed by ten corporators, who took one hundred shares or $10,000 worth of stock each; and that the sum of $5,000, as required by law, had been paid in. On the faith of this, A. became a subscriber to the shares of the company. It turned out that some of the subscriptions mentioned in the articles of association were fictitious, designed merely to entrap others into taking shares in the concern, and that the $5,000 required by law to be paid in had not been paid in. It was held that these facts constituted a good defense to an action for calls,[4] the court not explaining how the defendant came to be entrapped into subscribing for shares by articles of association which stated that there were no shares to be subscribed for.

§ 1409. Continued.—The directors of a company publish a prospectus stating, amongst other things: 1. That more than half the shares have been subscribed for; 2. That the company have contracted to purchase estate A., on which the vendors have expended £70,000; 3. That the company have contracted to buy estate B. On the contrary, the facts were: 1. That the promoter of the company had signed a document applying for more than half the shares for himself or his

[1] Central Plank Rd. Co. *v.* Clemens, 16 Mo. 365; Occidental Ins. Co. *v.* Ganzhorn, 2 Mo. App. 205; *post*, § 1849.

[2] Smith *v.* Reese River Co., L. R. 2 Eq. 263.

[3] Kesley *v.* Northern Light Oil Co., 54 Barb. (N. Y.), 111.

[4] Occidental Ins. Co. *v.* Ganzhorn, 2 Mo. App. 205.

nominee, but he had paid no deposit on the shares, and he ultimately took only two hundred shares, the rest having been allotted to general applicants; 2. That the promoter had not spent anything on estate A., but had agreed to buy it from vendors who were alleged, but not proved, to have spent £70,000 upon it; 3. That there was no binding contract as to estate B., but that the promoter had arranged terms with the owners, on which they would be willing to sell to him, and had also arranged terms on which he would sell to the company if the allotment of shares took place. Under these circumstances it was held that the plaintiff, who had taken shares on the faith of the prospectus, and had filed his bill before any proceedings for winding up the company, was entitled to be relieved from his shares, on the ground of misrepresentations in the prospectus.[1] - - - - Where the shareholder was illiterate, could not read, did not hear the articles of association read, but was induced to subscribe by a party interested in obtaining subscriptions to the stock of the company, who falsely represented to him that, in case he subscribed, he would not, according to the conditions of the articles, be required to pay for his stock until the amount of $20,000 had been subscribed, it was held that this entitled the person so subscribing to avoid his subscription.[2] - - - - Where the agent sent out by a railroad company to procure subscriptions to its stock represented that the corporation was in good pecuniary condition and repute; that the part of the road completed was earning money very rapidly, and that the net earnings of the road for three months then last past had been equal to four and a half per cent. of the entire cost of the road, whereas the person making the representations well knew that the company was on the verge of bankruptcy and without credit, its stock and bonds of little value, and the road not earning the amount represented, it was ruled that the subscriber could not be held to his contract.[3]

§ 1410. Continued.—The promoter of a company goes into the "directory market," as it has been aptly called,[4] and gets influential gentlemen to the necessary number to agree to act as directors in the proposed company, under a promise that they shall not have to pay anything into the concern. He causes to be issued to them the necessary shares to qualify them to act as directors, as paid-up shares, for which

[1] Ross *v.* Estates Investment Co., L. R. 3 Ch. 682.

[2] Wert *v.* Crawfordsville &c. Turnpike Co., 19 Ind. 242.

[3] Waldo *v.* Chicago &c. R. Co., 14 Wis. 575.

[4] By Vice-Chancellor Wood in Kent *v.* Freehold Land Co., L. R. 4 Eq. 597, and in Henderson *v.* Lacon, L. R. 5 Eq. 259.

he afterwards pays, out of the moneys received from innocent subscribers. He then issues a prospectus, stating that "the directors and their friends have subscribed a large portion of the capital, and they now offer to the public the remaining shares." The directors have subscribed nothing, except as stated, and only a few shares comparatively have been taken by others, and those by a single firm. This is a shallow fraud, such as entitles those duped by it into subscribing for shares to a rescission of their contract, and those who have participated in it to a lecture from the bench.[1] - - - - So, a *condition precedent* to a subscription must be complied with *bona fide*. Thus, where the governor of a State was authorized to subscribe for stock in a company upon notification in writing that ten per cent. of the subscriptions had been paid in,— which was, in fact, paid in, but immediately returned to the subscribers, to be paid in labor upon the corporate work,— and the governor was notified by the board of directors that such ten per cent. of the subscriptions had been paid in, the State was held to be not bound by a subscription made on the credit of such certificate of the directors.[2] - - - - Neither a guardian nor an administrator can release without payment any valid security belonging to the trust estate in his hands; nor can a trustee make such release of property mortgaged for the benefit of infants. Therefore, where property of a corporation was incumbered by a trust deed, and the trustee released (which release was duly recorded) a portion of the trust property, agreeing to look only to the portion not released for payment; and the corporation obtained subscriptions to its stock on the assurance that there was no incumbrance on the property so released, and the subscriber for stock relied on this assurance,— it was held that the subscription was obtained on misrepresentation, and that no recovery could be had thereon.[3]

§ **1411. Continued.**—Likewise, the following state of facts constituted such a fraud by a director that it could be imputed to the company: C. was the sole director of a banking company in Ireland, by reason of the resignation of the remainder of the board. In order to induce parties in England to become shareholders, he published a totally false and fraudulent report of the board of directors, purporting to have been submitted to the shareholders at their annual general meeting, and an equally false balance-sheet to correspond, showing a

[1] Henderson *v.* Lacon, L. R. 5 Eq. 249.

[2] State *v.* Jefferson Turnpike Co., 3 Humph. (Tenn.) 305.

[3] Water Valley Manuf. Co. *v.* Seaman, 53 Miss. 655.

prosperous condition of the affairs of the company. Parties in England were thereby induced to become purchasers of shares, as they supposed, of shareholders; but, in reality, hitherto unappropriated shares were issued to them. On the winding up of this company the name of one of these shareholders was placed upon the list of contributories, and his application to have it removed was sustained: the court not disputing the principle that directors cannot be considered as agents of a body of stockholders to commit a fraud, but denying its application to this case, where the question was not whether a director is the agent of shareholders to commit a fraud, but whether, where a contract is entered into by the person sought to be bound, by reason of the fraud and misrepresentation of the director, the shareholders are at liberty to say, "The director is our agent to bind you, but he is not our agent to bind us."[1]

§ **1412. Continued.** — In another case, a radical change having been announced by the directors in the plan of business as set forth in the prospectus of the company, a holder of one hundred and twenty shares, which he had taken upon the faith of the representations in the prospectus, wrote to the secretary, demanding the return of his deposit and declining to have anything further to do with the company. The deposit was returned, but his name still remained on the register of shareholders. On the winding up of the company, seventeen months afterwards, his name was placed upon the list of contributories, and on application the Master of the Rolls ordered it to be removed, on the ground that he had been diligent in demanding the return of his deposit, and might have compelled the removal of his name at the time his deposit was returned, had he been aware that it was retained upon the register.[2] - - - - Similarly, a party applied for ten shares in a company, and, according to their practice of allotment, paid £1 per share at the time of application, and was informed by the secretary that the directors would allot to him ten shares on condition that he paid £2 additional on each share within a week; which he did not do, for the reason that before the expiration of the week he discovered misrepresentations in the prospectus. He demanded the return of his deposit, declined to pay anything more upon the shares, and defended an action brought against him by the company for calls. On the winding up of the company (at which time the action for calls was pending) it appeared that the applicant's name had been placed upon the share-register of the company as of the date when the directors passed upon

[1] Ex parte Ginger, 5 Irish Ch. (N. S.) 174.

[2] Fox's Case, L. R. 5 Eq. 118.

his application, though there was some doubt whether it was actually entered upon that date. The court held that the contract in question must be considered to have been *in fieri* until the end of the week, before which time the applicant repudiated it. He had continued consistent in his repudiation of it, and therefore he ought not to be made a contributory of the company.[1]

§ **1413. Continued.** — And so, in a case of gross misrepresentation and concealment in the prospectus of a company, which might have been discovered upon examination of the articles of association of the company and contracts made by them, which were open to inspection on demand, a party, having received the prospectus by mail, applied for shares and paid a deposit thereon. It was held that his neglect to make such inquiry and examination — he having never signed the articles of association, but relying upon the representations in the prospectus — was no answer to his demand to be relieved from the contract.[2] - - - - But even where shares have been taken and the articles of association signed, if it is a case of a company formed *bona fide* to carry into effect a particular project, and it has become obvious, from the existence of debts and the absence of funds, that the project will not succeed, and the company is in such a situation that it cannot carry on its affairs, and no intention of attempting to do so remains, but the only questions are, what is the amount of the liabilities of the company, and how are they to be discharged; and under these circumstances the directors, with a view of relieving themselves and the other shareholders from those liabilities, and to get other persons to participate in them, issue representations which they know to be false, in order to induce other persons to become shareholders, not for the purpose of carrying on the concern, but really for the purpose of paying a portion of their debts;— persons becoming shareholders under such circumstances cannot be compelled to contribute.[3]

§ **1414. Instances under the Foregoing Rules: Shareholders not Released.** — The promoters of a company induced several parties to become shareholders, and to sign the memorandum of association, on the faith of their express representation that certain other parties had agreed to become directors in the company. This representation, though honestly made, afterwards proved to be false, as the persons in question refused to have any thing to do with the company. This fact

[1] Pentelow's Case, L. R. 4 Ch. 178.

[2] Directors, &c. *v.* Kisch, L. R. 2 H. L. 99.

[3] Bell's Case, 22 Beav. 35.

becoming known to the subscribers, they did not expressly repudiate their subscription, though complaining loudly to the promoters that the representation on the faith of which they signed had not been complied with. They treated themselves as owners of shares, and endeavored to transfer them to others. The court held that they were not entitled to relief, especially as others had executed the company's deed and taken shares therein since the memorandum was signed by these parties, and probably on the faith of their subscription. They should not have relied so implicitly on the representation, but should have seen it fulfilled before signing themselves.[1]

§ **1415. Continued.** — And where a director in a company solicited a person to become a shareholder, made false representations to him as to its condition, and at the same time exhibited to him a printed report of the directors, embodying a balance-sheet and profit-and-loss account rendered to the company, and approved by the company at an annual meeting, these circumstances did not constitute a case of fraud sufficiently strong to relieve the shareholder from his liability; for, by the act of Parliament under which the company in question was established, such reports of directors and balance-sheets were for the information of shareholders only, and if the directors publish them to induce persons to take shares, they are exceeding the limits of their duty. Moreover, in the present case no authority from the board of directors was shown to have been exercised by the single director who communicated with the shareholder and exhibited to him the printed report and balance-sheet; besides, the subscriber, though having the means of discovering the fraud, had received one dividend, and never expressly repudiated the transaction until the company ceased to do business.[2] - - - - A person, being a holder of twenty shares, purchased thirty more from executors, in regard to which he never executed any deed of transfer, as required by the company's deed of settlement, though he received dividends upon these thirty shares, and a certificate from the company that he was the owner of fifty shares. He afterwards wrote to the manager for information as to the condition of the company, who informed him, among other things, that "dividends are now payable half-yearly, and you will be entitled to one for the last half-year, which will probably be paid in March." This statement was willfully false, as the capital of the company had been long since lost. The shareholder then purchared fifty additional shares (in fact, but without his knowledge) from the directors: they were shares forfeited by previous owners. As to these fifty shares he did not execute the

[1] Gibson's Case, 2 De G. & J. 275.

[2] Nicol's Case, 3 De G. & J. 387.

requisite deed of settlement, but, as upon the others, received dividends for a short time, and a certificate that he was the owner of 100 shares. Upon these facts the court decided to allow his name to be retained upon the list of contributories, as, all parties concurring, they were competent to waive the formality of a deed of transfer. The misrepresentation of the directors afforded no ground for relief, as directors could not be agents of a company for this purpose.[1]

§ 1416. Continued. — This principle was affirmed under the following state of facts: D. purchased, through a broker, 100 shares in a joint-stock company, fifty each from two parties. He, together with one of the vendors and the manager of the company, executed a deed of transfer of five shares only, paid the purchase-money for the 100 shares to the broker, and received two certificates from the company as evidence that he was duly entered on the books of the company as the owner of 100 shares. No dividends were received by D., and the following year the company was ordered to be wound up. D., after payment of sundry assessments, asked that he be relieved from his liability on the ninety-five shares, suggesting that the whole transaction of purchase was fraudulent as to him, and not complete as to the ninety-five shares. The court regarded the 100 shares as the subject of a single contract, and governed by the terms of the deed in respect of the five shares; and as to the suggestion of fraud by the directors, ruled as in the preceding case. D. was therefore retained as a contributory, without qualification, in respect of the 100 shares.[2] - - - - The following case of gross fraud on the part of the directors of a company did not constitute ground for the relief of persons who had been thereby inveigled into becoming shareholders in the concern: S. came to the office of the company and took five shares of its stock, executing the company's deed therefor. The deed being exceedingly voluminous, he did not read it, but was informed by the company's secretary, in response to his particular inquiry, that the deed contained a clause providing against any liability beyond the paid-up value of the shares. He afterwards took fifteen shares more, on the repeated assurance of limited liability, again executing the deed without reading it. The deed, as registered according to statute, contained no such limited-liability clause. The deed which S. executed on these occasions did contain such a clause, but it was on a false sheet, and fraudulently inserted by one of the directors. S. received dividends for four or five years afterwards on his shares, until the company was wound up. The

[1] Bernard's Case, 5 De G. & Sm. 283.

[2] Dodgson's Case, 3 De G. & Sm. 85.

court, in view of these circumstances, directed that his name be retained upon the list of contributories, on the ground that it was the duty of a shareholder to make himself acquainted with the contents of the deed *as registered.*[1]

§ 1417. Continued. — In another case the directors of a banking company, in February, 1864, issued a report declaring a dividend of fifteen per cent. upon the shares, and a bonus of ten per cent. and a large addition to the reserve fund. In June, 1864, they offered to the shareholders the option of taking (according to the proportion of shares held by each shareholder) certain reserved shares at a premium. On September 19, 1864, the company stopped payment. Shareholders who had taken these reserved shares endeavored, upon these facts, to show this issue of shares to have been made upon fraudulent misrepresentations. The lord chancellor (Hatherley), while admitting that the manner of conducting the business of the bank was "extremely hazardous and reckless," thought there was nothing in the glowing report of the directors in February, or the evidence adduced in respect of it, to satisfy the court that any misrepresentation whatever was made by the directors; or, if it was so made, that it was made to their knowledge, or with such a degree of carelessness and negligence on their part, in inspecting the accounts and concerns of the company, as to amount to a necessary implication of knowledge on their part of the representations being false. It was therefore unnecessary to consider how far the law would be applicable to a case of this kind if such misrepresentation of the directors had been established.[2]

§ 1418. Continued. — Application was made for shares in a railway company, the prospectus of which contained false and fraudulent statements. The shares were allotted and the deposit-money paid. On account of this payment a receipt was given, which could be exchanged for scrip certificates on the execution of the subscribers' agreement and the Parliamentary contract. These documents were never executed by the allottee of the shares in question. The projected enterprise was never carried out. The vice-chancellor (Shadwell), on application of the person to whom shares had been thus allotted to have his name removed from the list of contributories, ruled that his remedy was an action for damages against the parties who had practiced the fraud, but that the contract of subscription was not void. He felt constrained so to rule, as it was a just inference that there were various persons in

[1] Sheffield's Case, Johns. (Eng. Ch.) 451.

[2] Jackson *v.* Turquand, L. R. 4 H. L. 305.

the same situation, as innocent as the applicant in question. Were it established that this applicant was the only person, of those interested in this company, who had been duped and defrauded by the misrepresentations, the case might be different.[1] - - - - Where a corporation had different classes of transfer books for different classes of its stock, and stock brokers attached different values to the several classes, and a subscriber for stock, when he subscribed, was told by the officers of the corporation that his stock would be transferable on a particular class of books, which was afterwards refused, — it was held that this was not a fraud which would avoid the contract, but that the remedy of the stockholder was by an action for damages.[2] - - - - Where persons subscribed to the capital stock of the corporation without knowing that, by a fraudulent contract between the corporation and one of its officers, its stock had already been issued to such officer, to be by him transferred to the subscribers on payment to him of forty per cent. of its par value, it was held that the existence of such contract did not change them from subscribers to assignes of the stock, and that they were not released.[3]

Article III. Remedies of the Defrauded Shareholder against the Company.

§ 1424. In General. — It may be stated generally that any misrepresentations or concealments of facts, which materially affect the success of the undertaking, will, as between the company and the person who, on the faith of such misrepresentations or concealments, has been induced to take shares, entitle

[1] Parbury's Case, 3 De G. & Sm. 43.

[2] Lohman *v.* New York &c. R. Co., 2 Sandf. (N. Y.) 39.

[3] Bates *v.* Great Western Tel. Co., 134 Ill. 536; *s. c.* 25 N. E. Rep. 521.

him to a rescission of the contract;[1] will be a defense to suits for calls,[2] or to a suit for a specific performance of the contract of subscription;[3] and will entitle him to an injunction against suits for calls.[4]

§ 1425. **Scope of the Remedy in Equity.** — The fact that the courts of law afford a complete remedy against the individual perpetrators of such frauds does not oust the jurisdiction of equity. Fraud being one of the great heads of equity jurisdiction, it is well settled that these courts will entertain jurisdiction, in such cases, of a bill which seeks a repayment of the moneys received from the complainant under such a fraudulent contract, for the re-imbursement of his costs and charges, and for an account of the same.[5]

[1] Directors *v.* Kisch, L. R. 2 H. L. 99; Waldo *v.* Chicago &c. R. Co., 14 Wis. 575; Henderson *v.* Railroad Co., 17 Tex. 560; *s. c.* 67 Am. Dec. 675; Granger's Ins. Co. *v.* Turner, 61 Ga. 561. See the State *v.* Jefferson Turnp. Co., 3 Humph. Tenn. 305; Ashmead *v.* Colby, 26 Conn. 287; Ross *v.* Estates Investment Co., L. R. 3 Ch. 682; affirming *s. c.* L. R. 3 Eq. 122; Rawlins *v.* Wickham, 3 De G. & J. 304; Henderson *v.* Lacon, L. R. 5 Eq. 249.

[2] Bwlch-y-Plwm Lead Mining Co. *v.* Baynes, L. R. 2 Exch. 324; Glamorganshire Iron &c. Co. *v.* Irvine, 4 Fost. & Fin. 947; Davis *v.* Dumont, 37 Iowa, 47; Water Valley Man. Co. *v.* Seaman, 53 Miss. 655; Occidental Ins. Co. *v.* Ganzhorn, 2 Mo. App. 205; Crump. *v.* United States Mining Co., 7 Gratt. (Va.) 352; *s. c.* 56 Am. Dec. 116; Rives *v.* Montgomery &c. R. Co., 30 Ala. 92.

[3] New Brunswick &c. R. Co. *v.* Muggeridge, 1 Dr. & Sm. 363.

[4] Smith *v.* Reese River Co., L. R. 2 Eq. 263; *s. c.* L. R. 4 H. L. 64; Henderson *v.* Lacon, L. R. 5 Eq. 249; Directors *v.* Kisch, L. R. 2 H. L. 99. Practice in such cases: Thorpe *v.* Hughes, 3 Myl. & Cr. 742, where an injunction was denied; Askew's Case, L. R. 9 Ch. 664, where the shares having been fully paid up, it was ruled that the merits ought to be tried at law, in an action to recover back the purchase-money, and not by a motion in chancery, under § 35 of the Companies' Act, 1862, to have the plaintiff's name excluded from the list of shareholders. A court of equity has power to change or to *set aside the stock* in a corporation, in case of fraud as well as mistake. Bailey *v.* Champlain &c. R. Co., 77 Wis. 453; *s. c.* 46 N. W. Rep. 539.

[5] Hill *v.* Lane, L. R. 11 Eq. 215; Ramshire *v.* Bolton, 8 *Id.* 294; Colt *v.* Woollaston, 2 P. Wms. 155, 156; Slim *v.* Croucher, 1 De G., F. & J. 518; Green *v.* Barrett, 1 Sim. 45; Burrowes *v.* Lock, 10 Ves. 470; Evans *v.* Bicknell, 6 *Id.* 174. A decision of Lord Chancellor Cairns, in Ogilvie *v.* Currie, 37 L. J. Ch. 541, gives countenance to a contrary doctrine; but in Hill *v.* Lane, *supra*, Vice-Chancellor Stuart said that the doctrine was so well settled that it would be a misfortune to the public if there were any sufficient grounds for considering the jurisdiction doubtful.

§ 1426. Necessary Allegations in the Bill.— It is necessary to allege distinctly, and to prove, that the particular representation was a material inducement to his purchasing his shares. It is not sufficient to allege generally that the prospectus contained false statements, by which the plaintiff was deceived and drawn into the contract, but the precise misrepresentation must be distinctly stated, and it must also be stated that it formed a material inducement to the plaintiff to take the shares in the company.[1]

§ 1427. No Relief to One who was a Party to the Fraud. — A discharge from a subscription on the ground of fraud cannot be obtained by one who was himself a party to the fraud.[2] But a stockholder who has purchased the shares in good faith is not estopped from maintaining a suit to annul stock fraudulently issued before his purchase, because the *prior holder* of his shares has barred his right to relief by participation in the fraudulent transaction.[3]

§ 1428. Frame of the Bill: Blending Prayers for Different Kinds of Relief: Multifariousness. — Where certain persons confederated to organize a corporation for the purpose of selling to it certain worthless lands, which they represented to be rich in gold, and, by "salting" the land with gold-dust, and other fraudulent means, induced certain persons to believe that their representations were true, who, on the faith of the same, organized themselves into a corporation, and, as a corporation, entered into a contract for the purchase of such lands, it was held that such persons, on discovering the fraud, were entitled to maintain a bill in equity jointly with the corporation, and against the persons committing the fraud, for a rescission of the contract of purchase, the repayment of the moneys advanced to them, the return of certain notes given in payment, the cancellation of the subscriptions of the individual corporators to the stock of the

[1] Hallows *v.* Fernie, L. R. 3 Ch. 467, 476, per Lord Chelmsford, L. C.; affirming *s. c.* L. R. 3 Eq. 320.

[2] Southern Plk. Rd. Co. *v.* Hixon, 5 Ind. 166; Litchfield Bank *v.* Church, 29 Conn. 137; Graff *v.* Pittsburgh &c. R. Co., 31 Pa. St. 489. And see Smith *v.* Heidecker, 39 Mo. 157; *ante*, § 1399 *et seq.*

[3] Parsons *v.* Joseph, 92 Ala. 403; *s. c.* 8 South. Rep. 788.

corporation, and for an injunction. Such a bill, asking at once for a rescission of the contract between the corporation and the respondents, and for the cancellation of the subscriptions of the individual complainants to the stock of the corporation, was not multifarious, since it simply sought for the undoing of one general and complicated scheme of fraud.[1]

§ 1429. Cancellation of Subscription where Misrepresentation is Unknown to Subscriber. — If the directors of a corporation have put forth a material misrepresentation in order to induce the *public* to subscribe for its shares, and A., on the faith of this misrepresentation, subscribes for shares in the company, and, afterwards, *before discovering that it is a misrepresentation*, applies to have his subscription cancelled, and this is done, and the company is afterwards wound up, he can not be restored to the list of contributories. The fact that the directors were aware of the misrepresentation which induced him to subscribe, rendered the cancellation of his subscription valid, although he was not aware of it at the time and did not discover it until afterwards.[2]

§ 1430. Whether Necessary to Plead Fraud Specially. — The practitioner is cautioned that the answer to this question depends upon *the theories of pleading* which obtain in particular jurisdictions. The general rule is believed to be, that fraud, when relied on to defeat a recovery upon a contract, must be specially pleaded, both in those States which practice under the modern codes of procedure and those which practice under other systems; and this is but a branch of the larger doctrine that, where an action is upon a contract and the fact of the contract or agreement is admitted, but its legality is controverted, the defendant must plead specially the facts which he intends to prove as showing its illegality, and that he will not be permitted to prove such facts under a general denial.[3] The de-

[1] Ashmead *v.* Colby, 26 Conn. 287.

[2] Wright's Case, L. R. 7 Ch. 55; reversing, *s. c.* L. R. 12 Eq. 331.

[3] Goss *v.* Austin, 11 Allen (Mass.), 525; Granger *v.* Ilsley, 2 Gray (Mass.), 521; Denton *v.* Logan, 3 Metc. (Ky.) 434; Smith *v.* Owens, 21 Cal. 11; Campbell *v.* Hyde, 1 D. Chip. (Vt.) 65; Newell *v.* Hayden, 8 Ia. 140; Hagan *v.* Birch, *Id.* 309; Cummiskey *v.* Williams, 20 Mo. App. 606. Compare Boulton Carbon Co. *v.* Mills, 78 Iowa, 460, 464; *s. c.* 43 N. W. Rep. 290.

fense of fraud at common law could be made under the general issue, or under a general plea of fraud;[1] but under the modern codes of procedure it is almost universally held that it must be specially pleaded.[2] There is a conflict of doctrine on the question whether, in a defensive pleading, it is sufficient to allege fraud in general terms, or whether it is required to set out specially the facts constituting the alleged fraud which the pleader intends to prove. But, under the codes of procedure, the rule appears to be settled with great unanimity, that a party cannot prove fraud without charging it.

§ 1431. Necessary Elements of the Plea of Fraud. — To an action by a company against a shareholder, to recover the amount of a call made by the directors on his shares of stock, the following may be stated as the necessary elements of a plea of fraud: 1. A distinct allegation of the matter in which the fraudulent representation or concealment consisted.[3] A general charge that the subscription was procured through fraud, it is supposed, would be bad for want of sufficient particularity of statement,— it would not apprise the opposite party of the nature of the defense. 2. That he used reasonable diligence to make himself acquainted with the matters of fact in respect of which the fraud is charged,[4] and that, within a reasonable time after discovering the facts, he repudiated his contract and offered to surrender his certificate.[5] In other words, he must show that he did all that

[1] Cohee *v.* Cooper, 8 Blackf. (Ind.) 115.

[2] Jenkins *v.* Long, 19 Ind. 28; *s. c.* 81 Am. Dec. 374; Farmer *v.* Calvert, 44 Ind. 212; Keller *v.* Johnson, 11 Ind. 337; *s. c.* 71 Am. Dec. 355; Clapp *v.* County, 5 Ia. 15; *s. c.* 68 Am. Dec. 678; Cushee *v.* Leavitt, 5 Cal. 169; *s. c.* 63 Am. Dec. 116; Hynson *v.* Dunn, 5 Ark. 395; *s. c.* 41 Am. Dec. 100; Giles *v.* Williams, 3 Ala. 316; *s. c.* 37 Am. Dec. 692; Davis *v.* Hooper, 4 Stew. & Port. (Ala.) 231; *s. c.* 24 Am. Dec. 751. The learning and wisdom of the late Supreme Court Commission of Missouri made the action of *replevin* an exception to this rule. Young *v.* Glasscock, 79 Mo. 374. A subordinate appellate court in that State followed this rule in Stern Auction Co. *v.* Mason, 16 Mo. App. 473. Compare Tyler *v.* Larimore, 19 Mo. App. 458; Cummiskey *v.* Williams, 20 Mo. App. 606, 612.

[3] Goodrich *v.* Reynolds, 31 Ill. 490, 497; *s. c.* 83 Am. Dec. 240.

[4] As to the obligation, *at common law*, to use diligence, see *ante*, § 1371; as to the contrary rule in equity, § 1372 *et seq.*

[5] Upton *v.* Englehart, 3 Dill. (U. S.) 496, 505; Bwlch-y-Plwm Lead Mining Co. *v.* Baynes, L. R. 2 Exch. 324.

could have been done, under the circumstances, to free himself from liability.[1]

§ 1432. Manner of Pleading Fraud in Particular Jurisdictions. — In Illinois, such a plea must show that the false representations were made by agents of the company, authorized to make them,[2] and that they knew them to be false when made.[3] Another court — but upon what ground is not perceived — has held an answer to such a statement, setting up fraud, bad for not averring that the alleged fraudulent representations were peculiarly within the knowledge of the company or its agents, and such as the defendant had a right to rest and rely upon.[4] In Ohio a stockholder answered that, after he had ceased to be a member of the corporation, the *note* sued on was *extinguished* by the giving of a new one, and that the *old note* was subsequently *obtained by fraud*. This was held sufficient on demurrer.[5] In Indiana, in an action to recover personally from certain stockholders of a draining association, under a peculiar statute, an

[1] Deposit Gen. Life Ins. Co. *v.* Ayscough, 6 El. & Bl. 761. To an action by the company against a shareholder for calls, the defendant pleaded that he was induced to become a shareholder by the fraud of the plaintiffs; that he had never recognized, since notice of the fraud, any rights or liabilities in himself as such shareholder, nor received any benefit from his shares; and that, within a reasonable time after notice of the fraud, he had repudiated the shares, and given notice to the plaintiffs of his repudiation. This was held a good plea to such an action at common law. Bwlch-y-Plwm Lead Mining Co. *v.* Baynes, L. R. 2 Exch. 324.

[2] Goodrich *v.* Reynolds, 31 Ill. 490, 497; *s. c.* 83 Am. Dec. 240.

[3] *Ibid;* White *v.* Watkins, 23 Ill. 482.

[4] Thornburgh *v.* Newcastle &c. R. Co., 14 Ind. 499. In an action by a railway company for calls, the Court of Queen's Bench, Patteson, Coleridge, and Earle, JJ., being present, an application was made to file thirteen pleas, some of which the court allowed to be filed, and others it disallowed. The case is quite a chapter on defensive pleading in such cases. The following plea, amongst others, was allowed: "That at the time of making the calls the capital of the company, required by its Act of Parliament, was £2,000,000; that by a subsequent act relating to the company it was not at liberty to put in force its powers until capital to the amount of £1,500,000 had been *bona fide* subscribed; but that a great portion of said subscription had been fraudulently obtained by the plaintiffs; that there was no subscrip- to the amount aforesaid at the time of making the calls, and that the plaintiffs had no power to make the calls until the subscription had been made. Waterford &c. R. Co. *v.* Logan, 14 Jur. 346.

[5] Wheeler *v.* Faurot, 37 Ohio St. 26.

answer was held insufficient which, although setting up fraud in procuring the defendants to become members, did not *implicate the plaintiff* therein.[1] The rule that one who has contracted with a company by its corporate name cannot *dispute the existence of the corporation* has been held not to apply where one who was induced, by fraudulent false representations, to subscribe for stock in an *illegal and pretended corporation*, is sued by it upon his subscription.[2]

1433. Instructing the Jury in such a Case. — There is no better case for the guidance of *nisi prius* courts, in an action for calls where the defense is fraud, than the case of the Glamorganshire Iron & Coal Co. *v.* Irvine,[3] tried by a jury before Mr. Justice Willes in 1866. That learned judge, in summing up, commenced by saying: "1. It is a fraud to state dishonestly for the purpose of gain that which is false in fact and material, either knowing it to be untrue or recklessly without knowing or caring whether it is true or false, for the purpose of its being acted upon as true, and of so deceiving the person who seeks to avoid the transaction into which he is thereby misled. 2. A person who is taken in by a fraud may elect to avoid the transaction within a reasonable time after the discovery of the fraud, and before he has taken any benefit under it. 3. A company is not answerable for the fraud of individual directors, or of directors acting otherwise than on a board, or by the authority of the company. 4. But that a company cannot, any more than a private individual, enforce a contract to which a party has been procured by the fraud of its agents." The best way to apply these propositions to the case in hand (an action by a company for calls), he said, was to ask, "Was the defendant defrauded? Who defrauded him? What was the fraud?" The question whether there was a falsehood in fact in the prospectus was to be determined with reference to the view the jury took of the whole of the evidence.[4]

§ 1434. Evidence in Support of the Defense of Fraud. — In a well reasoned case it has been held that the *representations*

[1] Reeder *v.* Maranda, 66 Ind. 485.

[2] Occidental Ins. Co. *v.* Ganzhorn, 2 Mo. App. 205.

[3] 4 Fost. & Fin. 955.

[4] The Glamorganshire Iron & Coal Co. *v.* Irvine, 4 Fos. & F. 947, 955.

of the agent of the corporation may be given in evidence to show the fraud by which subscriptions to the stock of a corporation were obtained, if such representations were a part of a scheme of fraud participated in by the officers of the corporation authorized to manage its affairs, or if the representations were such as the subscriber might reasonably presume the agent had authority to make.[1] Where a party subscribes to the capital stock of a corporation, upon condition that a certain number of shares shall be subscribed for, it is not competent for him to introduce evidence to show that that number has not been subscribed for by persons pecuniarily responsible, unless it appears that the corporation has acted in *bad faith;* and in such a case, upon the question whether the corporation acted in good faith at the time of its organization, the *declarations of a stockholder*, whose subscription is alleged to be fraudulent, made long after the organization of the corporation, are inadmissible.[2]

Article IV. Time Within Which a Rescission Must be Claimed.

§ 1438. Diligence Required of the Subscriber in Disaffirming. — A subscription to stock which has been obtained by

[1] Custar *v.* Titusville Gas &c. Co., 63 Pa. St. 381.

[2] Penobscot R. Co. *v.* White, 41 Me. 512; *s. c.* 66 Am. Dec. 257.

fraudulent representations may be annulled by the subscriber, if he rescinds promptly, and before the rights of creditors or subsequent stockholders have accrued.[1] Conversely, there is much authority for the proposition that it cannot be annulled in any case, as against creditors of the corporation who have not participated in the fraud.[2] And all the authorities unite upon the doctrine of Oakes *v.* Turquand,[3] that where a person has been drawn into a contract to take shares in consequence of certain representations, he must proceed with diligence to ascertain the truth or falsehood of such representations, in order to entitle him to a rescission of his contract.[4] In another case,[5] cited, with approval, by Lord Chelmsford, in Oakes *v.* Turquand,[6] and in Downes *v.* Ship,[7] Lord Cairns used the following language: "It is his bounden duty, at the earliest practicable moment, to ascertain what is the charter or title deed under which the company in which he has agreed to become a shareholder is carrying on business. If the memorandum and articles of association are in existence when he applies for shares, and if he agrees to take his shares on the footing of the memorandum and articles of association (which would seem to be the case here), then I think that he ought to be held bound to look to the memorandum and articles of association before he applies for shares. But where the memorandum and articles of association are not in existence at the time of application, I think that, at the very latest, when he receives his allotment of shares he ought to satisfy himself that there is nothing in the memorandum or articles of association to which he desires to make any objection." [8]

§ 1439. General Doctrine in England. — With respect to the time within which a person who has been induced by fraud to take shares in a corporation must claim a rescission of his

[1] McDermott *v.* Harrison, 9 N. Y. Supp. 184; Re Estate Investment Co., L. R. 4 Ch. 497 (where *one* proceeded, and *ten* by agreement abided the result and were not cut off by a winding up decree.)

[2] *Post*, § 1439.

[3] L. R. 2 H. L. 325.

[4] Lawrence's Case, L. R. 2 Ch. 412; Kincaid's Case, L. R. 2 Ch. 426; Wilkinson's Case, L. R. 2 Ch. 536; Upton *v.* Tribilcock, 91 U. S. 45; Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 380; Cedar Rapids Ins. Co. *v.* Butler 83 Iowa, 124; *s. c.* 48 N. W. Rep. 1026 (*four years* after discovery, too late).

[5] Peel's Case, L. R. 2 Ch. 674, 684.

[6] L. R. 2 H. L. 352.

[7] L. R. 3 H. L. 359.

[8] L. R. 2 Ch. 674, 684.

contract in order to be entitled to it, the question is to be considered in two aspects: 1. Where it affects the rights of other *shareholders* merely, the company being solvent or a "going concern." 2. Where it affects the rights of *creditors*, the company having stopped payment, or winding-up proceedings having commenced. The authorities appear to justify the following statements: 1. The claim for rescission, in order to have any standing in court, must be made in the shortest possible time after discovery of the fraud, or after the person seeking the rescission might, by a fair exercise of his opportunities of knowledge, have discovered it.[1] 2. It will not be entertained, in any event, in the English and Canadian courts of equity, after winding-up proceedings have been commenced.[2] 3. Neither will it be entertained after the company has stopped payment and the directors have called an extraordinary general meeting of the shareholders for the purpose of passing a resolution to wind up the company.[3] 4. It seems also clear, upon principle, that it will not be entertained after the company has stopped payment by reason of insolvency;[4] but a recent holding in England is to the effect that the mere circumstance that the company is insolvent at the time when he takes proceedings to rescind does not, in the absence of countervailing equities, deprive him of his right of rescission.[5]

§ 1440. Must be Claimed while the Company Continues a "Going Concern." — A shareholder claiming a rescission of his

[1] As to the time within which a suit in equity must be brought to restrain an action for calls, and the diligence with which such a suit must be prosecuted, see the remarks of Lord Cottenham, in Thorpe *v.* Hughes, 3 Myl. & Cr. 742, 761.

[2] Oakes *v.* Turquand, L. R. 2 H. L. 325; Kent *v.* Freehold Land Co., L. R. 3 Ch. 493; reversing *s. c.* L. R. 4 Eq. 588; Stone *v.* City & County Bank, 3 C. P. Div. 282. Re Central Bank of Canada, 25 Can. L. J. 238, 245; Burgess's Case, 15 Ch. Div. 509. It has been quaintly observed that the question then to be considered is, not who is the person who is the owner of the shares, but who is liable in respect of the legal tenancy at the time the tree was cut down. Lord Westbury, in Barrett's Case, 4 De Gex, J. & S. 421.

[3] Tennent *v.* Glasgow Bank, 4 App. Cas. H. L. (Sc.) 615.

[4] See the reasoning of Earl Cairns, L. C., in the case last cited.

[5] Carling *v.* London &c. Bank, 56 L. J. (Ch.) 321; 56 L. T. (N. S.) 115; 35 Week. Rep. 344. See also Ex Parte Hale, 55 L. T. (N. S.) 670.

contract on the ground of fraud must come within the shortest limit of time which is fairly possible in such cases.[1] In the language of an English equity judge of great learning and experience, the leading principle in all these cases is this: "A man must not play fast and loose. He must not say, 'I will abide by the company if successful, and I will leave the company if it fails;' and therefore, whenever a misrepresentation is made of which any one of the shareholders has notice, and can take advantage of to avoid his contract with the company, it is his duty to determine at once whether he will depart from the company, or whether he will remain a member. When I mean to say 'as soon as he has notice,' I do not mean that he may stand by when a great number of people tell him that misrepresentations have been made by which shareholders have been induced to take shares, and that he may wait until it is decided by a court of justice that there have been misrepresentations. On the contrary, I mean that it is his duty to inquire whether there is any misrepresentation or not."[2]

§ **1441. Doctrine of Oakes v. Turquand Considered.** —In a case decided in the English Court of Appeal in 1877,[3] the three lords justices before whom the appeal was heard, Bramwell, Brett and Cotton, concurred in the view that the doctrine of Oakes *v.* Turquand[4] is that a person who has been induced to take shares by fraudulent misrepresentations or concealment cannot, after the company has become insolvent and ordered to be wound up, repudiate his liability as a contributory. Bramwell, L. J., understood the doctrine of that case to be this: "Where a company is shown by a winding-up to be insolvent, and where the remedies of the creditors, who have trusted the company upon the strength of the uncalled capital and of the names upon the register, would be interfered with by the withdrawal of members,

[1] Lord Cairns's judgment in Scholey *v.* Central R. Co. of Venzeula, L. R. 9 Eq. 266, n.

[2] Lord Romilly, M. R., in Ashley's Case, L. R. 9 Eq. 263, 268. In another case the same learned judge expressed the opinion, that a *delay of four months*, after becoming acquainted with all the facts, before filing a bill for a rescission would interpose a serious difficulty; but the case went off on its merits. Heymann *v.* European Central R Co., L. R. 7 Eq. 154.

[3] Stone *v.* City and County Bank, 3 C. P. Div. 282.

[4] L. R. 2 H. L. 325.

the power to rescind a contract to take shares is gone."[1] "I doubt," said he, "whether a shareholder is liable upon the ground of estoppel. I think his liability depends upon a principle similar to that upon which the decision in Kingsford *v.* Merry[2] proceeded. It was there held that if the owner of goods sells them owing to a fraudulent representation, and if before he discovers the fraud another person acquires some claim to them, he cannot afterwards rescind the contract. And I think it clear, upon the authorities, that, wherever the rights of other persons intervene, a contract to take shares, though induced by fraud, cannot be rescinded. * * * I think * * * the principle of Oakes *v.* Turquand shows that where a company is being wound up, either compulsorily, voluntarily, or under the supervision of the court, it is too late to rescind a contract to take shares, although that contract has been induced by fraud."[3] "In my opinion," said Brett, L. J., "Oakes *v.* Turquand really decided that, upon the true construction of the Companies Act, 1862, the members of a company, although they have been induced to take shares by fraud, are prevented from rescinding their contracts after the winding-up has commenced. A voluntary winding-up commences when the resolution to wind up is passed; and therefore after that time a shareholder cannot escape from liability to contribute to the payment of the company's debts. * * * In my opinion the judgment in Oakes *v.* Turquand did not proceed upon the ground of estoppel, nor did it proceed upon the ground that a compulsory winding-up, or a winding-up under supervision, is to be considered as in the nature of a bankruptcy, and that a voluntary winding-up is to be considered as in the nature of an administration suit. I am of opinion that the judgment in Oakes *v.* Turquand cannot be said to be a decision as between a shareholder and creditors, but that it was a decision between a shareholder and the liquidator of the company, representing the company. The true reason of the decision seems to me to be that the existence of the creditors prevents a member, although he has been induced to take his shares by fraud, from rescinding his contract after the commencement of a winding-up under the Companies Act, 1862, what-

[1] Stone *v.* City and County Bank, 3 C. P. Div. 307.

[2] 11 Exch. 577.

[3] *Ibid.* 308, 309.

ever may be the nature of that winding-up; and if he continues a member, and if his name remains upon the register, of course he can be made a contributory. The reasoning in Oakes *v.* Turquand seems to me to apply just as much to a voluntary winding-up as to a compulsory winding-up, or a winding-up under supervision; none of these kinds of winding-up are to be deemed bankruptcies; they are all modes of dealing with companies in difficulties, to be substituted for proceedings in bankruptcy, and they all fall within the principle of Oakes *v.* Turquand."[1] "According to Oakes *v.* Turquand," said Cotton, L. J., "no person who, at the commencement of the winding-up, is *de facto* a member, that is, who has, by a contract not previously avoided, become a member, — can withdraw from the distribution for the benefit of the creditors any part of the company's assets, either by recalling money paid by him to the company or by taking himself off the list of contributories, —that is to say, by taking himself out of the category of those liable to pay further calls; in consequence of the distribution of assets amongst the creditors, a member cannot insist upon the equity, which he might otherwise have claimed, to be relieved from his contract with the company."[2] The same view of the scope of Oakes *v.* Turquand was taken, in another case, by Lord Hatherley. "As regards the shareholders," said he, "all they are entitled to, according to Oakes *v.* Turquand, is that the *status* of any subscriber shall not be altered after the date of the winding-up."[3] "I take it to be perfectly clear," said Vice-Chancellor Malins, "since the case of Oakes *v.* Turquand, that where there is a question of whether a man is a contributory or not, no misconduct of the company, or false representation or misrepresentation made by them as a means of inducing him to take shares, will relieve him from bearing the responsibility which he, at all events, owes to creditors, whatever effect it may have between himself and other shareholders."[4]

§ 1442. Doctrine of Henderson v. Royal British Bank.— The doctrine underlying Oakes *v.* Turquand,[5] and upon which

[1] 11 Exch. 310, 312.

[2] 11 Exch. 314.

[3] Wright's Case, L. R. 7 Ch. 60.

[4] Pugh & Sharman's Case, L. R. 13 Eq. 572.

[5] L. R. 2 H. L. 325.

the vice-chancellor and two of the law lords[1] confessedly based their judgments, received for the first time a clear exposition, in England, in the case of Henderson *v.* The Royal British Bank, decided in the Court of Queen's Bench in 1857.[2] In that case a creditor of a joint-stock bank, having prosecuted his claim to judgment, and his execution being ineffectual, sought to charge a shareholder under the provisions of a statute which has many counterparts in this country.[3] It was held that the shareholder could not resist the claim on the ground that he had been induced to become such by fraud on the part of the bank, and that he had repudiated the shares after the bank became bankrupt, but soon after the discovery of the fraud, the judgment creditor being no party to the fraud. The following is the judgment of Lord Campbell, C. J.: "This was an application for leave to take out execution against a shareholder; and the proposed answer to the application was that the shareholder had been induced by fraud to take the shares. He had remained a shareholder for some time, and received dividends, and acted in all respects as a shareholder until the Royal British Bank stopped payment, and until its bankruptcy; and he then gave notice that he was no longer a shareholder, and, as far as he could, disaffirmed the contract under which he became a shareholder, as being induced by the fraud of the directors; he demanded back all the moneys he had paid, and, being a depositor himself, he demanded the deposit and all the advances. The question is, whether, if it were established that this fraud had been practiced upon him, it could be an answer to this application. If there were any doubt about it, we should not make this rule absolute; but we should direct a *scire facias* to issue, so that the question might be raised on the record. We entertained no doubt on the argument; but, being informed that similar applications had been made to the courts of Common Pleas and Exchequer, and that rules were depending in those courts, we thought that, upon a matter of this sort, it would be well if we had a conference with the other judges before our judgment was given. That conference has taken place: and the

[1] Lords Chelmsford and Cranworth.

[2] 7 El. & Bl. 356.

[3] 7 & 8 Vict. c. 113, § 10.

judges are unanimously of opinion that this can be no answer to the application, either upon principle or authority. This is an application by a creditor, who, upon the faith of the party, who was then a shareholder, and who held himself out to the world as a shareholder, and being one, gave credit to the bank. He has obtained judgment against the bank. There were no assets of the bank as a company. And the application now is that execution may issue against the party individually. It would be monstrous to say that he, having become a partner and a shareholder, and having held himself out to the world as such, and having so remained until the concern stopped payment, could, by repudiating the shares on the ground that he had been defrauded, make himself no longer a shareholder, and thus get rid of his liability to the creditors of the bank, who had given credit to it on the faith that he was a shareholder. It would be monstrous injustice, and contrary to all principle. Whether he could say that, with regard to other shareholders not privy to the fraud, we need not say; there may be some difficulty about that. But that is not the question we have to determine; which is, simply, whether this is an answer to a creditor, who has given trust upon the faith of his being a shareholder. Suppose this were a common partnership, and that there was credit given to the firm: would it be any answer to an action by the creditor against one of the partners that the defendant was fraudulently induced by the other partners to become a partner? *Inter se* that might be considered: but, as between the firm and a creditor, it is a matter wholly immaterial. Now the party here admits that he is a shareholder, and acted as such until the bank stopped payment. His name was placed on the register, and remains on the register. There is some irregularity in that register: but we are of opinion that all that is said in the statutes as to the manner in which the register shall be intituled and made up is only directory and not conditional, and that he was bound, at all events *prima facie*, by his name appearing on the register, notwithstanding those errors. The rule will therefore be absolute."[1] This decision was considered so satisfactory that it was followed without

[1] Henderson *v.* Royal British Bank, 7 El. & Bl. 356, 363.

comment by the Court of Common Pleas[1] and the Court of Exchequer.[2]

§ 1443. Illustrations of the Foregoing.— Accordingly, where, after discovering that the directors of a company had procured subscriptions to its capital stock by means of a fraudulent prospectus, a meeting of shareholders was held, and a committee of dissentient shareholders was formed, one of whom prosecuted a suit in equity to enjoin actions for calls under an agreement made with the directors that such actions should be stayed to await the determination of this suit, and it was finally decided in his favor, — it was held that a shareholder who had not joined in this proceeding, but who had waited until this suit was decided, without dissenting, would not afterwards be heard in a court of equity to claim a rescission of his contract of subscription on the ground of fraud.[3] But a dissentient shareholder was entitled to await the decision of a suit in equity brought for the purpose stated, and was not precluded from instituting a proceeding to annul his contract of subscription, by the mere fact that he did not file a separate bill before the termination of the suit in question. The filing of such a bill, under the circumstances, would have been vexatious and improper.[4] Under the same facts a shareholder, who, though not one of the so-called "dissentient shareholders," that is, not one of those who had formally joined together and subscribed a fund for the purpose of defending actions for calls, had refused to pay his allotment, on the ground that his subscription had been obtained by fraud, but had failed to bring a suit to have his contract of subscription rescinded, in consequence of a circular of the directors to the effect that they did not in-

[1] Dossett *v.* Harding, 1 C. B. (N. S.) 524; Powis *v.* Harding, 1 C. B. (N. S.) 533.

[2] Daniell *v.* Royal British Bank, 1 H. & N. 681. In Deposit &c. Co. *v.* Ayscough, 6 El. & Bl. 761, *s. c.* 2 Jur. (N. S.) 812, determined in the Queen's Bench in 1856, before Lord Campbell, C. J., a plea to an action for calls, that the subscription was induced by the fraud of the plaintiff, was held bad for not averring that the defendant had repudiated the contract, and had done nothing under it to make him liable as a shareholder. In Bwlch-y-Plwm Mining Co. *v.* Baynes, L. R. 2 Exch. 324, determined in the Court of Exchequer in 1867, before Chief Baron Kelly and Barons Martin and Bramwell, the defendant to a similar action pleaded that he had been induced to becom a shareholder by the frauds of the plaintiffs; that he had never recognized, since notice of the fraud, any rights or liabilities in him as such shareholder, nor received any benefit from his shares, and that, within a reasonable time after notice of the fraud, he had repudiated the shares, and given notice to the plaintiffs of his repudiation. It was held that this was a good plea.

[3] Ashley's Case, L. R. 9 Eq. 263.

[4] Pawle's Case, L. R. 4 Ch. 497.

tend to bring any further actions for calls until the termination of the suit brought by the dissentient shareholders, was entitled to have his name taken from the list of contributories after the company was ordered to be wound up.[1] - - - - Shares were allotted to A. (who had applied for them on the faith of a fraudulent prospectus) on the 14th day of July. After paying two calls he heard in September, rumors that the prospectus was fraudulent. On September 28, he examined documents at the company's office, which convinced him that such was the case. On January 28 following, he filed a bill for a rescission, having done nothing in the meantime which amounted to an acquiescence. It was held that he came in time.[2]

§ 1444. Further Illustrations: Variance between Prospectus and Memorandum. — Perhaps the most frequent illustrations of this, to be met with in the English cases, are those cases in which subscribers have attempted to rescind their contract of subscription on account of a variance between the *prospectus*, on the faith of which they gave their subscription, and the *memorandum*, or contract of association under which the company was organized. A substantial variance between these instruments releases the shareholder. Here the English cases unite with the American[3] in holding that a person who has agreed to become a shareholder in a company of a certain description cannot, as a matter of common right, be held bound to the responsibilities of a shareholder in a company of a different description.[4] But, as stated in the last section, this rule supposes that the subscriber himself has been guilty of no fault. He must proceed with diligence, and without unreasonable delay, to ascertain the true facts of the case; and if he finds a substantial variance between the prospectus and memorandum of association, he will be entitled to a rescission of his contract, provided he proceeds with diligence and in the proper manner to secure it; otherwise, in the event of the company being wound up, he will be put upon the list of contributories.[5] The variance, however, must be *substantial;* a mere difference between the language of the prospectus and that of the memorandum will not relieve him from liability. The obligations in-

[1] McNiell's Case, L. R. 10 Eq. 503.

[2] Venzuela (Central R. Co. of) *v.* Kisch, L. R. 2 H. L. 99.

[3] *Ante*, § 1262 *et seq.*

[4] Ship's Case, 2 De G. J. & S. 544; Stewart's Case, L. R. 1 Ch. 574; Webster's Case, L. R. 2 Eq. 741; Oakes *v.* Turquand, L. R. 2 H. L. 325: Downes *v.* Ship, L. R. 3 H. L 343.

[5] Lawrence's Case, L. R. 2 Ch. 412; Kincaid's Case, L. R. 2 Ch. 426; Wilkinson's Case, L. R. 2 Ch. 536; Peel's Case, L. R. 2 Ch. 674; Oakes *v.* Turquand, L. R. 2 H. L. 325; Downes *v.* Ship, L. R. 3 H. L. 343; Whitehouse's Case, L. R. 3 Eq. 790; Taite's Case, L. R. 3 Eq. 795.

curred under the two documents must be substantially different.[1] This doctrine of diligence applies as between the subscriber and another shareholder, or between the subscriber and the official liquidator; but it does not apply in a contest between the shareholder and the person who proposed the prospectus and afterwards issued the memorandum of association.[2]

§ **1445. Notice of such Variance.** — It has been held in one case that the fact that a subscriber attended a meeting of the shareholders for the purpose of correcting a variance between the prospectus and memorandum of the association on a point of minor importance, but on account of which the stock-exchange had refused to appoint a settling-day, was not of itself sufficient to fix the subscriber with notice of other and more important variances, he swearing positively that he did not know of them.[3] But this ruling becomes immaterial in view of the rule of diligence laid down in the last section; for, after the lapse of a reasonable time to enable the subscriber to inform himself of the facts, he will be conclusively presumed to have known, or, what is the same in effect, he will be charged with the consequences of such knowledge.[4] "I think," said Lord Chelmsford, in Oakes *v.* Turquand,[5] "that persons who have taken shares in a company are bound to make themselves acquainted with the memorandum of association, which is the basis upon which the company is established. If they fail to do so, and the objects of the company are extended beyond those described in the prospectus (a fact which may be easily ascertained), the persons who have so taken shares on the faith of the prospectus ought, in my opinion, to be held to be bound by acquiescence. In Ship's case[6] the judges partly proceeded on the oath of the party that he never had notice of the extension of the objects of the company. However true this may be, it depends entirely upon the party's own assertion; and the answer to it is, 'You might have made yourself acquainted with the proceedings of the company, and ought to have done so.'"

§ **1446. Rectification of Register.** — The English Companies Act, 1862, § 35, has supplied a remedy to a person whose name has been wrongfully placed on the register of a company, by permitting him to apply to any superior court of law or equity for a rectification of the register. It has been held that if a person's name has been

[1] Downes *v.* Ship, L. R. 3 H. L. 343.
[2] *Ibid.*
[3] Stewart's Case, L. R. 1 Ch. 574.
[4] Peel's Case, L. R. 2 Ch. 674; Oakes *v.* Turquand, L. R. 2 H. L. 325.
[5] L. R. 2 H. L. 351.
[6] 2 De G. J. & S. 544.

wrongfully placed on the registry of a joint-stock company, he must resort to this remedy to have it removed. It is not in the power of the directors, by simply removing his name from the registry, to indemnify him against the liability arising from such wrongful use of his name;[1] but this doctrine is obviously unsound.[2] The ground on which subscribers have frequently applied for a rectification of the register has been that of substantial variances between the prospectus and memorandum of association, as seen in the last section.[3] Applications of this kind have been also made on other grounds, and have been generally refused.[4]

§ **1447. Restitutio in Integrum.** — The person defrauded can not, *under the Scotch law*, claim what is termed in that law a *restitutio in integrum*, where the circumstances have so changed that he cannot restore exactly what he purchased; and the law of England is said to be the same.[5] This he is disabled from doing in the following case: Where the company whose shares he was fraudulently induced to purchase has, since such purchase, with his consent, changed from an unincorporated to an incorporated company; for this change disables him from restoring the very thing which he had been fraudulently induced to purchase, namely, the shares in the defunct unincorporated company.[6] On the same grounds, one who had been induced by fraud to purchase shares in a company organized under the English "cost book" principle, could not recover back the money paid for them, after the company, with his consent, was registered as a company with limited liability.[7] In such cases, although most of the persons who were responsible for the frauds in question

[1] Martin's Case, 2 Hem. & M. 669.

[2] Wright's Case, 7 Ch. 55.

[3] In the following cases subscribers succeeded in procuring the removal of their names from the register on this ground: Stewart's Case, L. R. 1 Ch. 574; Downes *v.* Ship, L. R. 3 H. L. 343; Webster's Case, L. R. 2 Eq. 741. In the following cases such applications were refused on account of laches: Lawrence's Case, L. R. 2 Ch. 412; Kincaid's Case, L. R. 2 Ch. 426; Wilkinson's Case, L. R. 2 Ch. 536; Peel's Case, L. R. 2 Ch. 674; Whitehouse's Case, L. R. 3 Eq. 790; Taite's Case, L. R. 3 Eq. 795.

[4] Simpson's Case, L. R. 9 Eq. 91; Ward's Case, L. R. 3 Ex. 180; Ward & Henry's Case, L. R. 2 Eq. 226; L. R. 2 Ch. 431; Sargent's Case, L. R. 17 Eq. 273; Askno's Case, L. R. 9 Ch. 664; Parker's Case, L. R. 2 Ch. 685.

[5] Clarke *v.* Dickson, El. Bl. & El. 148.

[6] Western Bank of Scotland *v.* Addie, 1 H. L. (Sc.) 145, 166.

[7] Clarke *v.* Dickson, El. Bl. & El. 148.

became members of the new company, they did not thereby transfer to the new company a responsibility for the frauds committed by them while acting as agents of the old company.[1] For the same reasons, the person so defrauded cannot, after the happening of such a change, recover compensation of the new corporation in damages. He comes too late. The new corporation is not the person who is guilty of the fraud; and though it is, by the express provisions of the statute by which it is incorporated, made liable for the duties and the obligations incurred before incorporation (that is, the duties and obligations of the preceding company), yet this does not transfer to it a liability to be sued for frauds or other wrongful acts committed by its directors before its incorporation.[2]

§ 1448. **After the Commencement of Winding-up Proceedings,** the House of Lords has ruled that an application to be relieved from liability as a shareholder, on the ground of fraud practiced by agents of the company in procuring the subscription, comes too late.[3] But if the shareholder has repudiated the contract within a reasonable time, and has commenced proceedings to obtain a rescission before the commencement of the winding-up proceedings, his right to a rescission will not be cut off by the fact that winding-up proceedings intervene before his suit for a rescission comes to a hearing.[4] Neither can a shareholder sustain an action at law on this ground against the company, to recover back the amount which he has paid on account of his subscription, after winding-up proceedings have commenced, although he has repudiated his contract within a reasonable time after he has discovered the fraud, so that his action, but for the intervention of the winding-up proceedings, would have been in time.[5] The rule is applicable to a voluntary winding-up, as well as to a compulsory winding-up, the object of both proceedings being the same, namely, to realize the assets of the company for dis-

[1] Western Bank *v.* Addie, *supra.*

[2] Western Bank *v.* Addie, *supra.*

[3] Oakes *v.* Turquand, L. R. 2 H. L. 325.

[4] Reese River Co. *v.* Smith, L. R. 4 H. L. 64; affirming *s. c.* L. R. 2 Ch. 604; L. R. 2 Eq. 264; reversing *s. c.* 36 L. J. Ch. 385. Reaffirmed by Lord Cairns, L. C., in Kent *v.* Freehold Land Co., L. R. 3 Ch. 493.

[5] Stone *v.* City & County Bank, 3 C. P. Div. 282.

tribution among its creditors, which assets include uncalled capital.[1]

§ **1449. Rule in this Country.** — In the United States there does not appear to be any fixed rule as yet established, like that of Oakes *v.* Turquand, and other English cases just cited, which cuts off the shareholder from claiming a rescission after the commencement of winding-up proceedings, without reference to the diligence he has exercised in discovering his rights and in repudiating the contract on account of the fraud practiced upon him. Relief has been denied by the Supreme Court of the United States *after* the intervention of *proceedings in bankruptcy*, but not upon the sole ground that, after the intervention of such proceedings, the application came too late. The ground taken was that the person who has been induced to subscribe for shares of the stock of a corporation must use diligence in ascertaining his real position; and, if he finds that fraud has been practiced upon him, he must be prompt in repudiating the contract. In the case in question the shareholder had slept upon his rights for three years, and did not repudiate the contract until an assignee in bankruptcy had brought an action for sums due on his subscription; and it was held, on general principles of equity, that this repudiation of the contract came too late.[2] In a case growing out of the bankruptcy of the same company, Dillon, J., in a well-considered judgment, contrasted the decisions under the English Companies' Act with the rule which should obtain in this country, where there is no registry of stockholders, as in England. He thought that this difference would indicate that a shareholder here ought not to be held bound to proceed with the same promptitude to discover his rights and disaffirm the

[1] Stone *v.* City and County Bank, 3 C. P. Div. 282; overruling Hall *v.* Old Talargoch Lead Mining Co., 3 Ch. Div. 749.

[2] Upton *v.* Tribilcock, 91 U. S. 45, 55. Mr. Justice Miller, with whom concurred Mr. Chief Justice Waite and Mr. Justice Bradley, dissented from the result, but not from the doctrine before stated. Mr. Justice Hunt, who delivered the opinion of the court, cited Buford *v.* Brown, 6 B. Mon. (Ky.) 553; Beckford *v.* Wade, 17 Ves. 87, 97; Jones *v.* Turberville, 2 Ves. 11; Duke of Beaufort *v.* Neald, 12 Cl & Fin. 248, 286; Smith's Case, L. R. 2 Ch. 613; Denton *v.* Macneil, L. R. 2 Eq. 352; Peel's Case, L. R. 2 Ch. 684.

contract, if fraudulent, as in England.[1] We incline to think that the tendency of the American decisions will support this view.

§ 1450. No Rescission after Bankruptcy or Insolvency. — It may be concluded from a number of American cases that no rescission will be allowed after the bankruptcy or insolvency of the corporation has supervened, unless under very exceptional circumstances, if at all; [2] and further, that the fact that a stockholder was induced to take the stock by the false representations is no defense in an action by judgment creditors of the corporation on his *statutory liability*.[3] The Supreme Court of Georgia have held that one who has been induced to subscribe for shares in a corporation by fraudulent representations, cannot, in an action against the corporation after it has become insolvent, recover the amount paid by him on his subscription until the claims of creditors of the corporation are satisfied.[4] The court regards the question as one arising between him and the corporation, with which the creditors have nothing to do.[5]

§ 1451. Further of this Subject. — Where a stockholder in an insurance company had given his note, secured by real estate, for the balance of his subscription, and had stood by for two years without taking means to ascertain the truth or falsehood of the representations by which he was induced to become a stockholder, and in the meantime his note, so secured, was held out to the public as so much assets of the company, and *bankruptcy* finally *supervened*, it was held that, when sued by the assignee in bankruptcy for the unpaid balance of his subscription, his defense came too late.[6] In a case in the United States Cir-

[1] Upton *v.* Englehart, 3 Dill. (U. S.) 496, 505.

[2] Upton *v.* Tribilcock, 91 U. S. 45; Webster *v.* Upton, 91 U. S. 65; Sanger *v.* Upton, 91 U. S. 56; Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 380; Chubb *v.* Upton, 95 U. S. 665; Michener *v.* Payson, 13 Nat. Bank Reg. 49; Farrar *v.* Walker, 3 Dill. (U. S.) 506.

[3] Briggs *v.* Cornwell, 9 Daly (N. Y.), 436.

[4] Turner *v.* Grangers &c. Co., 65 Ga. 649; *s. c.* 38 Am. Rep. 801.

[5] Howard *v.* Glenn, 85 Ga. 238; *s. c.* 11 S. E. Rep. 610.

[6] Farrar *v.* Walker, 3 Dill. (U. S.) 506, n., before Mr. Justice Miller at circuit. The opinion of Mr. Justice Miller in this case is one of the best illustrations of the clearness and force of expression which characterize all of his judgments.

cuit Court for the Eastern District of Pennsylvania, very similar in its facts to the last case, McKennan, J., after attempting to lay down a definite rule on the subject, expressed the opinion that, *after bankruptcy*, and when sued for the unpaid balances of his subscription by the assignee in bankruptcy, as the representative of the creditors, this defense was not available to the shareholder. Like Mr. Justice Miller, in the case of Farrar *v.* Walker,[1] he placed his conclusion on the principle of estoppel.[2] On similar grounds a defense of irregularities in the issue of stock was held by the Supreme Court of Ohio not available to stockholders in a suit brought against them by a receiver *after insolvency*.[3] In Ruggles *v.* Brock,[4] such a defense was held unavailable to the stockholder when sued by the *receiver* of the company for the unpaid balance of his subscription. But the case was complicated with circumstances of fraud and acquiescence, for the defendant received dividends and served as a director.

§ 1452. **Rescission must be Claimed before Liabilities Incurred.** — Possibly the view of Caruthers, J., in a Tennessee case, is the correct one: The defrauded stockholder must notify the company and claim a rescission before they incur liabilities on the faith of his contract. This of course assumes what obviously the language of the learned judge imports, — that a reasonable time has elapsed, after discovering the fraud, to enable him to do so.[5]

§ 1453. **Rule Where there are no Creditors.** — In an important case in Connecticut, where stockholders sought in equity a rescission of a subscription to the stock of the company fraudulently imposed upon them, it was objected that a decree for the complainants would deprive the company of all its assets and leave nothing for the creditors; but the court held this objection untenable, for there were no creditors before it.[6] Where the case is not complicated with any question of estoppel urged on behalf of creditors or other stockholders, — where the case stands

[1] 3 Dill. (U. S.) 506, n.

[2] Michener *v.* Payson, 13 N. B. R. 49, 51.

[3] Clarke *v.* Thomas, 34 Ohio St. 46.

[4] 6 Hun (N. Y.), 164.

[5] Cunningham *v.* Edgefield &c. R. Co., 2 Head (Tenn.), 23.

[6] Ashmead *v.* Colby, 26 Conn. 287.

simply as a question between the corporation seeking to retain an advantage acquired through fraud, and a person who has been defrauded by its agent, — the ordinary rule of equity as to the time which will bar the person defrauded from claiming a rescission of his contract would obviously apply in the same manner as though the question arose between two natural persons.

§ 1454. Laches with Circumstances Showing Acquiescence after Knowledge.— Some of the cases proceed upon a doctrine analogous to the equitable doctrine of *laches;* and this is manifestly the proper ground on which to put the question where the shareholder is seeking affirmative relief in a court of equity. In one such case it was said by Withey, J.: "If, through misrepresentation and fraud, any one is induced to subscribe for or purchase of such stock, he may repudiate the stock and be relieved of his relation as stockholder, provided he does so promptly and uses reasonable diligence in measures to that end. But it will be too late to set up the misrepresentation and fraud after he has paid repeated assessments, participated, in person or by proxy, in the meetings of stockholders, and continued to hold his stock for a year or more, and until the company has, by reason of losses, become insolvent, and creditors seek to have its assets applied to the payment of their claims."[1] The Supreme Court of the United States has several times adjudged that in a suit brought by creditors, or by a person representing them,— such as an assignee in bankruptcy,— against stockholders, to recover the amount of their unpaid subscriptions, it is no defense that the stockholder was induced to become such by false and fraudulent representations made by the corporation or by its agent.[2] In these cases, however, the question was so complicated by circumstances of acquiescence and laches on the part of the defendant, that we doubt whether it can be stated in the broad terms above given, without qualification; and, after an examination of the cases, we incline to think that the correct doctrine, at least as applied to a subscription to an *increase* of stock, is

[1] Upton *v.* Jackson, 1 Flipp. (U. S.) 413, 418; *s. c.* 10 Myer Fed. Dec., § 137.

[2] Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 380; Upton *v.* Tribilcock, 91 U. S. 45; Chubb *v.* Upton, 95 U. S. 667; *s. p.* Payson *v.* Withers, 5 Biss. (U. S.) 269.

that stated by Mr. Justice Miller, in a dissenting opinion, namely, that "where an agent of an existing corporation procures a subscription of additional stock in it by fraudulent representations, the fraud can be relied on as a defense to a suit for the unpaid installments when suit is brought by the corporation; and that if the stockholder has in reasonable time repudiated the contract, and offered to rescind before the insolvency or bankruptcy of the corporation, the defense is valid against the assignee of the corporation."[1] It has been held, in England, that where persons have been led to become partners to an undertaking by means of false and fraudulent representations contained in a prospectus, if they, with knowledge of the fraud, continue to be members, and act as such, they cannot afterwards come into a court of law and claim to have back their deposit or calls, on the ground of their not being members by reason of the fraud practiced upon them.[2] In a case where this principle was professedly applied, but which seems to violate it, it appeared that certain persons had been induced to execute the deed of settlement of a company, as shareholders, by a representation made by the promoters of the company, who were intrusted with the deed for the purpose of obtaining signatures to it, that two specified individuals would execute it. This representation, though honestly made, proved erroneous. On learning this the subscribers named repudiated their liability as shareholders, but assented to a proposal to transfer their shares to others. It was held that they were contributories.[3]

§ 1455. **Acquiescence by Unreasonable Delay.** — The principle that an unreasonable delay by either party in disaffirming a contract of subscription on the ground of fraud may cut off the right to disaffirm, is illustrated by a variety of cases. It should be observed in this connection that the lapse of time may be so great as to afford evidence of acquiescence without reference to the attending circumstances. Thus, where, after *seven years*, a subscriber sought to avoid his subscription on the ground of fraud of the company's soliciting agent, and no excuse

[1] Upton *v.* Tribilcock, 91 U. S. 55. In this view Waite, C. J., and Bradley, J., concurred.

[2] So stated by the Lord Chancellor, in Gibson's Case, 2 De G. & J. 284.

[3] Gibson's Case, 2 De G. & J. 275.

was shown for the delay, it was held that the presumption was against the subscriber's right to avail himself of these facts till he had accounted for his delay.[1] On the other hand where the directors and other agents of a corporation have, for many years, acquiesced in a subscription for stock, made by a person in the names of his children or others, who have exercised acts of ownership over it, and voted on it without objection, as their own, the corporation will not afterwards be allowed to treat the subscription as if it were a fraudulent use, by the original subscriber, of mere names, to secure a greater number of votes than he would be entitled to if the stock stood in his own name.[2]

§ 1456. Corporation Estopped by Acquiescence in Ultra Vires Rescission. — This principle of estoppel works against either party to the contract. When, therefore, a subscription to the stock of a manufacturing corporation was claimed to have been obtained by false representations, and a resolution was passed by the board of directors cancelling the subscription, and, under such resolution, the subscribers returned to the company their stock certificates, it was held that four years' acquiescence by the corporation in the action of the board operated as a ratification of the rescission, even though it was *ultra vires*.[3]

Article V. Remedies Against Persons Guilty of the Fraud.

[1] Dynes *v.* Schaeffer, 16 Ind. 165. Compare Deposit Gen. Life Ins. Co. *v.* Ayscough, 6 El. & Bl. 761.

[2] Creed *v.* Lancaster Bank 1 Ohio, 1.

[3] McDermott *v.* Harrison, 9 N. Y. Supp. 184.

§ **1460. Action at Law for Deceit.** — If the foregoing [1] remedies fail, the defrauded shareholder will be entitled to maintain an action of deceit, or of assumpsit for money had and received, against those who practiced the fraud upon him, whether they converted the money obtained from him to their own use or not, and whether they carried out their fraudulent scheme after obtaining the money, or not.[2] But an action for damages for deceit cannot be maintained against the company; it can only be maintained against the persons who have been guilty of the deceit.[3] Neither does the responsibility of the directors for frauds of this nature follow, as of course, the shares on their transfer from an allottee to his vendee. In order that such a third person should be enabled to maintain any proceeding at law or in equity against the directors on such a ground, he must show some direct connection between them and himself in the issuing of the prospectus, and its influence on his conduct in becoming an allottee.[4] It has been held

[1] *Ante,* § 1424, *et seq.*

[2] Paddock *v.* Fletcher, 43 Vt. 389; Nelson *v.* Luling, 4 Jones & Sp. (N. Y.) 544; Wontner *v.* Shairp, 4 Com. Bench, 404; Jarrett *v.* Kennedy, 6 *Id.* 318.

[3] *Post,* § 1462.

[4] Peek *v.* Gurney, L. R. 6 H. L. 377; (affirming *s. c.* L. R. 13 Eq. 79; overruling Bagshaw *v.* Seymour, 18 C. B. 903; *s. c.* 29 L. J. (Exch.) 62, n., and Bedford *v.* Bagshaw, 4 H. & N. 538; *s. c.* 29 L. J. (Exch.) 59; and adopting Scott *v.* Dixon, *Id.* 62, n.,

in New York that the gist of this action is fraudulent intent, and that actual knowledge of the falsehood of the representation must be brought home to the defendant.[1]

§ **1461. Limitation of Such Actions.** — Such an action may be brought at law at any period before the statute of limitations has interposed a bar; and courts of equity, by analogy, follow the same period of limitation.[2]

§ **1462. Directors' Liability.** — If the directors of a company put forth false prospectuses, or other fraudulent misrepresentations, whereby a person is induced to purchase shares in the company, and he thereby sustains damage, he may recover the same of the directors in an action at law for deceit.[3] The *gist* of this action is *fraudulent intent*, and for this reason it will not lie against the corporation itself, since a fraudulent intent is not imputable to an artificial body; nor in case of joint-stock companies will the fraudulent intent of the directors and agents be transferred by intendment from them to the body of shareholders.[4] This does not in any manner impugn the rule that a corporation is answerable *civiliter* for the frauds of its agents. That rule is well established,[5] and proceeds upon the ground

and Gerhard *v.* Bates, 2 El. & Bl. 476); Perry *v.* Hale, 143 Mass. 540; *s. c.* 10 N. E. Rep. 174, — holding that the defrauded shareholder cannot maintain such an action against the other shareholders, because of the fraud of a *promoter*, without connecting them with the fraud.

[1] Wakeman *v.* Dalley, 51 N. Y. 27; Nelson *v.* Luling, 4 Jones & Sp. (N. Y.) 544.

[2] Peek *v.* Gurney, L. R. 6 H. L. 377.

[3] Davidson *v.* Tulloch, 3 Macq. H. L. (Sc.) 783; Bedford *v.* Bagshaw, 4 Hurl. & N. 538; *s. c.* 29 L. J. (Exch.) 59; Scott *v.* Dixon, 29 L. J. (Exch.) 62, n; Paddock *v.* Fletcher, 42 Vt. 389; Nelson *v.* Luling, 4 Jones & Sp. (N. Y.) 544; affirmed 62 N. Y. 645; Wontner *v.* Shairp, 4 C. B. 404; Jarrett *v.* Kennedy, 6 C. B. 318; Bale *v.* Cleland, 4 Fost. & F. 117; Gerhard *v.* Bates, 2 El. & Bl. 476; *s. c.* 20 Eng. L. Eq. 129 Thomp. Off. Corp., p. 158; Clarke *v.* Dickson, 6 C. B. (N. S.) 453; Cross *v.* Sackett, 2 Bosw. 617; Cazeaux *v.* Mali, 25 Barb. (N. Y.) 578; Morgan *v.* Skiddy, 62 N. Y. 319. If directors of a corporation knowingly issue *spurious stock*, and obtain a loan on it, they are personally liable. The corporation need not first be sued, nor is its corporate existence in issue. Exchange Bank *v.* Sibley, 71 Ga. 726. For a useful note on this subject, see 16 Am. & Eng. Corp. Cas. 414, n.

[4] New Brunswick &c. R. Co. *v.* Conybeare, 9 H. L. Cas. 725, 740; Western Bank of Scotland *v.* Addie, L. R. 1 H. L. (Sc.) 145, 157.

[5] Western Bank of Scotland *v.* Addie, L. R. 1 H. L. (Sc.) 145; National Exchange Co. *v.* Drew, 2 Macq.

that a corporation will not, any more than a natural person, be permitted to retain an advantage which comes to it through the fraud of its agent.[1] But an action at law for damages, the gist of which is fraudulent intent, can obviously be maintained only against him who has been guilty of the fraudulent intent.[2] It is said that the representations must not only be false in fact, but they must have been made *with an intent to deceive.* This intent may be inferred from evidence showing that the party making them knew of their falsity at the time, or at least professed knowledge of their truth, when, in point of fact he was conscious he had none. But in either case, falsehood uttered with intent to deceive, is essential.[3] We apprehend that it is not necessary to show that the defendants knew that the representations were untrue,[4] but that it will be sufficient if it be made to appear that they made them with a fraudulent mind and motive, intending thereby to deceive and defraud, and indifferent as to whether they were true or not.[5]

103; *s. c.* 1 Pat. (Sc.) App. 482; Mackay *v.* Commercial Bank, L. R. 5 P. C. 394; Ranger *v.* Great Western R. Co., 5 H. L. Cas. 72; New Brunswick &c. R. Co. *v.* Conybeare, 9 *Id.* 711; Brockwell's Case, 4 Drew. 205; Ayre's Case, 25 Beav. 513; Blake's Case, 34 *Id.* 639; Ex parte Ginger, 5 Irish Ch. (N. S.) 174.

[1] Western Bank of Scotland *v.* Addie, L. R. 1. H. L. (Sc.) 145, 158; Lord Chelmsford, in Oakes *v.* Turquand, L. R. 2 H. L. 325, 344; Rives *v.* Montgomery Plank Road Co., 30 Ala. 92; Henderson *v.* Railroad Company, 17 Tex. 560; *s. c.* 67 Am. Dec. 675. See on the general principle, Atwood *v.* Wright, 29 Ala. 346; Bowers *v.* Johnson, 10 Smed. & M. (Miss.) 169; Meadows *v.* Smith, 7 Ired. Eq. (N. C.) 7; Harris *v.* Delamar, 3 *Id.* 219; Bridgman *v.* Green, 2 Ves. Sr. 627; Huguenin *v.* Baseley, 14 Ves. 273; *s. c.* 2 White & Tudor Ld. Cas. in Eq. 556.

[2] Arthur *v.* Griswold, 55 N. Y. 400. In an action which seeks to charge the directors of a corporation for fraudulent misrepresentations, it is, therefore, error to admit evidence of false representations made by another agent of the company. *Ibid.*

[3] Wakeman *v.* Dalley, 51 N. Y. 27; *s. c.* Thomp. Off. Corp. p. 299; Nelson *v.* Luling, 4 Jones & Sp. (N. Y.) 544; affirmed 62 N. Y. 645; Cazeaux *v.* Mali, 25 Barb. (N. Y.) 578, 583. To the same general principle, see Evans *v.* Collins, 5 Q. B. 803.

[4] See, however, Arthur *v.* Griswold, 55 N. Y. 400; Addington *v.* Allen, 11 Wend. 374; Fusz *v.* Spaunhorst, 67 Mo. 256, 264.

[5] Taylor *v.* Ashton, 11 Mees. & W. 401, 415; Leffman *v.* Flanigan, 5 Phila. (Pa.) 155, 161; Shrewsbury *v.* Blount, 2 Man. & Gr. 475. As to what will be a sufficient allegation of an intent to deceive, see Gerhard *v.* Bates, 2 El. & Bl. 476; *s. c.* 20 Eng. L. & Eq. 129; Thomp. Off. Corp., p. 158; Matthews *v.* Stanford, 17 Ga. 543; *s. c. sub nom.* Sisson *v.* Matthews, 20 Ga. 848; Evans *v.* Collins, 5 Q. B. 804, 820; Rawlings *v.* Bell, 1 C. B. 951; Warner

§ 1463. Not Liable for False Representations Made under a Reasonable and Well-grounded Belief of their Truth. — By the common law of England, as lately settled in the highest judicial tribunal in that country, such an action will not lie where the representations, though untrue, were made *bona fide* and under a reasonable and well-grounded belief that they were true.[1]

§ 1464. Illustration: The Case of Derry v. Peek.— This rule, though apparently established in England as a rule of the courts of the common law,[2] seems to have been contested in the courts of equity until the year 1889, when it was laid down in a decision of the House of Lords, reversing the Court of Appeal. The case was this: The directors of a tramway company issued a prospectus reciting: "Incorporated by special act of Parliament, authorizing the use of *steam* or other *mechanical motive power.*" And reciting further: "One great feature of this undertaking, to which considerable importance should be attached, is that, by the special act of Parliament obtained, the company has the right to use steam or mechanical motive power instead of horses." The prospectus in another place mentioned "the unusually favorable conditions as to motive power open to the company." The fact was that the special act of Parliament, by which the company was incorporated, authorized the use of steam power or other mechanical power, *with the consent of the Board of Trade*, and subject to periodical renewals of such consent, and also with the consent of two local corporations, and subject to such conditions as they might prescribe. At the time when the prospectus was issued there was reasonable ground to believe that all of these consents *would be given.* But none of them had in fact *been given*, and two of them were afterwards *refused.* The plaintiff, who had been induced by this prospectus to invest his money in the shares of the company to his loss, brought an action against the directors for damages. Mr. Justice Stirling, before whom the cause was tried, held that there could be no recovery. His judgment was reversed in the Court of Appeal by Sir James Hannen and the Lords Justices. From their judgment an appeal was taken to the House of Lords, and their judgment has been reversed and that of Mr. Justice Stirling affirmed.[3]

v. Daniels, 1 Woodb. & M. (U. S.) 91, 107; Miner *v.* Medbrey, 6 Wis. 295.

[1] Derry *v.* Peek, 14 App. Cas. 337; reversing *s. c. sub nom* Peek *v.* Derry, 37 Ch. Div. 541. So previously held in Shrewsbury *v.* Blount, 2 Man. & Gr. 475.

[2] Shrewsbury *v.* Blount, 2 Man. & Gr. 475.

[3] Derry *v.* Peek, 14 App. Cas. 337; *s. c. sub nom.* Peek *v.* Derry, 37 Ch. Div. 541.

§ 1465. Comments on this Decision.— The principle which this decision really affirms is that if a party makes a statement as true, intending that another shall believe it and act upon it, which statement is known to the party making it to be not true, but which he, nevertheless, in good faith *expects* will turn out to be true, by reason of something which he expects will happen in the future, he is not guilty of an actionable fraud, even under the theory of courts of equity. Such a doctrine is obviously immoral and unjust. The person solicited to purchase shares has a right to be informed of the real facts and *to do his own expecting*, instead of having it done for him without his knowledge or consent by the other party to the bargain. If a man state a thing as true which he knows not to be true at the time when he makes the statement, he states a conscious falsehood, although he may have a well grounded belief that, by reason of something which he expects to happen in the future, it will turn out to be true. It is deceit to substitute his *belief* in the place of the *real fact*. The case is ably reviewed by Sir Frederick Pollock, editor of the *Law Quarterly Review*, in the October (1889) number of that publication. He speaks very plainly about it, but not more plainly than such a case deserves. He assails rather the grounds assigned for the decision than the decision itself. But it should seem that the result of the decision is equally assailable, and that no grounds could be assigned for such a decision which are not subject to assault. Sir Frederick Pollock, of course, speaks with some restraint, because that is due to any decision emanating from the highest appellate court in England. But he, nevertheless, feels constrained to say that "the decision of the House of Lords has dangerously relaxed the legal conception of honesty in the statement of facts, and will do no good, to say the least, to commercial morality." After referring to the language of Best, C. J., in Adamson *v.* Jarvis,[1] he pays an inferential tribute to American law, or at least to American judges and lawyers, when he adds the following: "I believe that the law will one day come to this, in other English speaking countries, if not here." The language referred to of Mr. Chief Justice Best is as follows: "He who affirms either what he does not know to be true, or knows to be false, to another's prejudice and his own gain, is both in morality and law guilty of falsehood, and must answer in damages." The question will have no rest until the rule is settled in conformity with this *dictum*. In Derry *v.* Peek the directors were liable upon any theory of fraud with which we are acquainted. They put forth a statement of fact as being true which was not true at the time when they asserted it. They put it forth with the intention that persons to whom

[1] 4 Bing. 66, 73, 74.

the representation was made should believe it and act upon it as true. The plaintiff read the representation, believed it, acted upon it as true, and thereby suffered loss. This, upon every sound theory, gave him an action against the persons making the representation. Nor was it a good defense, upon any sound or honest conception, for them to say: "Although the statement was untrue when we made it, yet we had reasonable grounds to believe that it would turn out to be true." The person who thus puts forth a statement as true upon a reasonable apprehension that it will turn out to be true, ought to be held to the obligation of a *guarantor* of the truth of the statement which he thus makes.[1]

§ 1466. This Rule Repealed in Great Britain by Statute.— A doctrine so opposed to sound commercial morality could not long be endured by a people chiefly engaged in trade, whose merchants habitually set a high value upon truth and fair dealing. Accordingly the rule in Derry *v.* Peek was soon abrogated by the following act of Parliament.[2]

Sec. 3 (1) Where after the passing of this act a prospectus or notice invites persons to subscribe for shares in or debentures or debenture stock of a company, every person who is a director of the company at the time of the issue of the prospectus or notice, and every person who having authorized such naming of him is named in the prospectus or notice as a director of the company or as having agreed to become a director of the company either immediately or after an interval of time, and every promoter of the company, and every person who has authorized the issue of the prospectus or notice, shall be liable to pay compensation to all persons who shall subscribe for any shares, debentures, or debenture stock, on the faith of such prospectus or notice, for the loss or damages they may have sustained by reason of any untrue statement in the prospectus or notice, or in any report or memorandum appearing on the face thereof, or by reference incorporated therein, or issued therewith, unless it is proved —

(a) With respect to every such untrue statement not purporting to be made on the authority of an expert, or of a public

[1] Professional comments on Derry *v.* Peek will be found in 5 Law Quart. Rev. 410; 6 *Id.* 72; 6 *Id.* 112; 7 *Id.* 106.

[2] Director's Liability Act 1890; L J. Stat. 403; L. R. Stat. 516.

official document or statement, that he had reasonable ground to believe, and did up to the time of the allotment of the shares, debentures, or debenture stock, as the case may be, believe, that the statement was true; and

(b) With respect to every such untrue statement purporting to be a statement by or contained in what purports to be a copy of or extract from a report or valuation of an engineer, valuer, accountant, or other expert, that it fairly represented the statement made by such engineer, valuer, accountant, or other expert, or was a correct and fair copy of or extract from the report or valuation. Provided always, that notwithstanding that such untrue statement fairly represented the statement made by such engineer, valuer, accountant, or other expert, or was a correct and fair copy of an extract from the report or valuation, such director, person named, promoter, or other person, who authorized the issue of the prospectus or notice as aforesaid, shall be liable to pay compensation as aforesaid if it be proved that he had no reasonable ground to believe that the person making the statement, report, or valuation was competent to make it; and

(c) With respect to every such untrue statement purporting to be a statement made by an official person or contained in what purports to be a copy of or extract from a public official document, that it was a correct and fair representation of such statement or copy of or extract from such document: or unless it is proved that having consented to become a director of the company he withdrew his consent before the issue of the prospectus or notice, and that the prospectus or notice was issued without his authority or consent or that the prospectus or notice was issued without his knowledge or consent, and that on becoming aware of its issue he forthwith gave reasonable public notice that it was so issued without his knowledge or consent, or that after the issue of such prospectus or notice and before allotment thereunder, he on becoming aware of any untrue statement therein, withdrew his consent thereto, and caused reasonable public notice of such withdrawal, and of the reason therefor, to be given.

(2) A promoter in this section means a promoter who was a party to the preparation of the prospectus or notice, or of the portion thereof containing such untrue statement, but shall not include any person by reason of his acting in a professional

capacity for persons engaged in procuring the formation of the company.

(3) Where any company existing at the passing of this act, which has issued shares or debentures, shall be desirous of obtaining further capital by subscriptions for shares or debentures, and for that purpose shall issue a prospectus or notice, no director of such company shall be liable in respect of any statement therein, unless he shall have authorized the issue of such prospectus or notice, or have adopted or ratified the same.

(4) In this section the word "except" includes any person whose profession gives authority to a statement made by him.

Sec. 4. Relates to indemnity where name of person has been improperly inserted as a director.

Sec. 5. Relates to contribution from directors, etc.

§ 1467. The Rule Opposed to Earlier Decisions in the English Court of Chancery. — As before suggested, the rule in Derry *v.* Peek had never been admitted to be the doctrine of equity, even in England, until it was thus declared by the House of Lords. That doctrine was forcibly denied by Sir George Jessel, the successor of Lord Romilly, in another case. "Persons," said he, "state a material fact to induce another person to act, and they state it untruly. They are careless, and, being ignorant, they are ill-advised; but they do state the material fact untruly, on which the other person acts. It is intended that other persons shall act on it. The object is, that he shall induce some other person to act on it. Is it in a civil court to be said, that the man who, either through carelessness or negligence, so misleads another as to induce him to part with valuable property, is not to be liable? Is he not to be liable, because he was misled by the advice of his solicitor? In all transactions in which men are liable they must choose their agents, whether legal or otherwise; and, having chosen them, they are responsible for their acts. The whole doctrine of equity depends on this. There is no more reason for excusing the man who acts on the advice of his solicitor, in this way, than there is for excusing the man who defends an action on the advice of his solicitor, and loses it, from paying the costs. Even in a criminal court it is no defense. If a man is indicted for obstructing a highway, he will not the less be found guilty because his solicitor advised him it was not a highway, and had never been dedicated to the public. Nor in any other case could it be alleged that a man is not to be held responsible for acting on advice which may have been given *bona fide*, but is not sound. Again, in a civil court, what is

it to the person defrauded that the person who made the false statement did not take sufficient care? If there are facts on which advice is wanted, or which raise a doubt, the directors should have put the substance of the resolution on the certificate, and then the purchaser would take the responsibility of seeing whether the legal result did or did not follow from the real facts of the case. There was no compulsion on the directors to make a statement that there was stock of such a date; and I see no reasonable ground for exempting them from the consequences of a voluntary statement, which turns out to be untrue and has misled another person. It appears to me, therefore, on the reason of the thing, that even if there were no authority, the directors ought to be held liable."[1] In support of this position Sir George Jessel referred to several authoritative cases.[2]

§ 1468. Decisions in Support of this View. — It may be worth while to examine these cases. In the first case, the trustee of an estate in a will, made a false representation to a creditor of the estate, that one of the distributees of the estate was entitled to the full sum of £288 as his distributive share, although ten years before, such distributee had made to another an assignment of one-tenth part of his share in the fund, of which assignment the trustee had notice. The trustee admitted that he had had notice, but alleged that at the time he was applied to for the opinion, he did not recollect it. It was held by Sir William Grant, M. R., that this was no defense. What the plaintiff had to show in order to charge him was (1), that the fact as represented was false; (2), that the person making the representation had a knowledge of the fact contrary to it. The plaintiff could not dive into the recesses of his heart so as to show whether he did or did not recollect it. It was at least gross negligence to answer the question without taking it upon himself to recollect whether it was true or not.[3] - - - - In the next case, on the occasion of a loan upon the security of a lease which the borrower represented himself as entitled to have granted to him for ninety-eight and one-half years, the lender required a written intimation from the alleged lessor of his intention to grant the lease, and the lessor, being apprised of the requisition and its object, signed the required intimation. The loan was made upon the faith of it, and afterwards the lessor granted a lease which was then mortgaged by the borrower to the lender. It turned out that the lessor had, some time before,

[1] Eaglesfield *v.* Marquis of Londonderry, 4 Ch. Div. 693, 704.

[2] Namely: Burrowes *v.* Lock, 10 Ves. 470; Slim *v.* Croucher, 1 DeG. F. & J. 518; Peek *v.* Gurney, L. R. 6 H. L. 377; *s. c.* Thomp. Off. Corp. 309.

[3] Burrowes *v.* Lock, 10 Ves. 475.

demised the same premises for the same term to the borrower, by whom it had since been assigned for value. It was held that the court had jurisdiction to direct repayment by the lessor to the lender, of the sum which he had advanced, with interest, and that it was a proper case for the exercise of such jurisdiction, although the lessor was not shown to have been guilty of fraud, or of having done more than forgotten the previous lease when he granted the second.[1]

§ 1469. Validity of Stock which Subsequently Becomes Worthless. — Quite consistently with this view it has been held that the mere fact that a person has allowed his name to be used for the purpose of floating the stock of the corporation which afterwards turns out to be worthless, will not make him liable, in the absence of proof that he participated in the publishing of the false representations.[2] "It must," says Lord Romilly, M. R., "be established that there was, by the prospectus, a misrepresentation made by the persons sought to be made answerable, knowingly false, and also that it was made by them with a view to deceive, and that it did deceive the plaintiff." In the opinion of the same learned and experienced judge, the equitable doctrine of constructive fraud has no application to cases of this kind. Here, to make the directors liable, they must have been guilty of a distinct fraud.[3]

§ 1470. Such Actions Distinguishable from Actions for Rescission. — It must be continually borne in mind that there is a marked distinction between actions, either at law or in equity for indemnity against directors who were guilty of fraud, and actions in equity for a rescission, on the ground of fraud, of a contract to take shares in their company. We apprehend that it is a settled principle of equity that a person is not bound to show actual, or moral fraud, in order to entitle him to a rescission of a contract, into which he was drawn by representations which were untrue; for how could the other contracting party be heard to say, "Because I made the misrepresentations honestly and in good faith, believing them to be true, I am,

[1] Slim *v.* Croucher, 1 DeG. F. & J. 518.

[2] Morgan *v.* Skiddy, 62 N. Y. 319. It was so held where the plaintiff, instead of purchasing shares, loaned money to the corporation. Arthur *v.* Griswold, 55 N. Y. 400.

[3] Ship *v.* Crosskill, L. R. 10 Eq. 73, 84, 85.

therefore, entitled to keep your money; and you must suffer the damages, although they were in fact untrue, and you entered into the contract on the faith that they were true."[1]

§ 1471. English Doctrine that the Plaintiff must have been an Immediate Purchaser from the Company.— The law of England, as settled by the House of Lords in a celebrated case, is, that where the fraudulent representations consist in a false prospectus of the projected company, only the original subscribers to the shares can maintain actions against the directors. If the original subscribers succeed in unloading them upon the innocent public before the bubble bursts and the fraud is discovered, the secondary purchasers have no redress, even in equity, against the directors. In that case a prospectus for an intended company was prepared by the projectors (the directors of the company), and issued by them to the public. It contained misrepresentations of facts, known to those who issued it, and also concealed the existence of a deed, which was material to be known, and which, if known, would in all probability have prevented the formation of the company. Being addressed to the whole public, any one might take up the prospectus and appropriate to himself its representations, by applying for an allotment of shares. It was held that when the allotment was completed the office of the prospectus was exhausted, and that a person who had not become an allottee, but only a *subsequent purchaser* of shares in the market, was not so connected with the prospectus as to render those who had issued it liable to indemnify him against the losses which he had suffered in consequence of his purchase.[2] Under this rule the directors might get the fruits of their fraud and escape all liability, by the simple device of colluding with certain persons to become the purchasers of the shares in the first instance, and to unload them upon the innocent public before the discovery of the fraud.

[1] *Ante*, § 1388. See for illustration, Reese River Co. *v.* Smith, L. R. 4 H. L. 64.

[2] Peek *v.* Gurney, L. R. 6 H. L. 377; *s. c.* Thomp. Off. Corp. 309 (affirming *s. c.* L. R. 13 Eq. 79); overruling Bagshaw *v.* Seymour, 18 C. B. 903; *s. c.* 29 L. J. (Exch.) 62, n., and Bedford *v.* Bagshaw, 4 H. & N. 338; *s. c.* 29 L. J. (Exch.) 59, and adopting Scott *v.* Dixon, *Id.* 62, n., and Gerhard *v.* Bates, 2 El. & Bl. 476; *s. c.* 20 Eng L. & Eq. 129; Thomp. Off. Corp. 158.

§ 1472. American Doctrine Otherwise. — Regarding the English rule, it is a subject of congratulation that a doctrine so plainly destitute of any foundation in reason and so opposed to common opinions of justice and business morality, has not obtained a foothold in this country. We follow the doctrine of the overruled decisions in England, and hold that it is not necessary, in order to support such an action, that the false representations were made directly to the plaintiff. It will be sufficient if they were contained in circulars, prospectuses, or other advertisements, with the view of influencing the public *at large*, or any member of the public who might be influenced by them, to purchase shares; and that the plaintiff saw them, and, on the faith of the statements contained in them, became a purchaser of shares.[1] Nor is it at all necessary that there should have been any personal communication between the plaintiff and the defendant.[2] It is no objection that fraudulent representations touching the character of corporate stock, by which it is designed to induce the public to purchase the same, are communicated to intending purchasers through an innocent intermediary employed by the co-conspirators. It is not necessary that the representations should have been communicated directly to the persons thereby induced to purchase the shares, nor is it necessary that they should have been concocted with the view of deceiving those particular persons; it is sufficient that they were concocted with the view of deceiving any person whom the deception might catch and impose upon.[3]

[1] Bartholomew *v.* Bentley, 15 Oh. 659; Cazeaux *v.* Mali, 25 Barb. (N. Y.) 578, 583; Cross *v.* Sackett, 2 Bosw. (N. Y.) 618; Clarke *v.* Dickson, 6 C. B. (N. S.) 453; Morgan *v.* Skiddy, 62 N. Y. 319. See also Davidson *v.* Tulloch, 3 Macq. H. L. (Sc.) 783; *post*, § 1500.

[2] Clarke *v.* Dickson, *supra;* Bedford *v.* Bagshaw, *supra.*

[3] Watson *v.* Crandall, 7 Mo. App. 233; *s. c.* affirmed, 78 Mo. 583. See also Cazeaux *v.* Mali, 25 Barb. (N. Y.) 578; Shotwell *v.* Mali, 38 Barb. (N. Y.) 445; Bruff *v.* Mali, 36 N. Y. 200. The Missouri court cited with approval the following observation of Lord Hatherly, then vice-chancellor, in Barry *v.* Croskey, 2 John. & H. 23, quoted by Lord Cairns in Peek *v.* Gurney, L. R. 6 H. L. at p. 413: "Every man must be held responsible for the consequences of a false representation made by him to another, upon which a third person acts, and so acting, is injured or damnified; provided it appear that such false representation was made with the intent that it should be acted upon by such third person in a manner that occasions the injury or loss." Compare Langridge *v.* Levy, 2 Mees. & W.

§ 1473. Illustrations of the Foregoing. — The directors of a joint-stock company, for the purpose of getting the shares of the company inserted in the official list of the stock exchange, falsely certified, through their secretary, to the secretary of the stock exchange, that two-thirds of their scrip had been paid up and was ready to be issued. On the faith of this, the shares of the company were inserted in the official list of the stock exchange, and the plaintiff, knowing the rules of the stock exchange not to insert shares in their official list unless two-thirds of the scrip had been paid upon, purchased some of the shares. The jury having found that the representations were fraudulently made, it was held that the defendant was liable to the plaintiff for the damages so sustained by him, although the representations were not made to him directly.[1] - - - - Several adventurers organized a lead mining and smelting company, distributed the shares of stock among themselves in certain proportions and elected themselves directors. They also elected as a director a gentleman in Boston who personally knew nothing of the character of the property or the prospects of the company. One of these co-adventurers who had paid no money into the concern was made president of the company and a large block of stock was transferred to him by the other associates. By means of fraudulent prospectuses, letters, oral representations and a sham dividend, he succeeded in selling a large quantity of the stock through the innocent director in Boston to persons residing in that city. The enterprise having proved a failure, these persons brought actions at law against the directors of the corporation for deceit. The case was investigated at great length before a referee, upon evidence almost wholly wrung from the co-adventurers themselves. The case discloses the usual incidents of the falsification of the corporate records and the loss or destruction of some of their books. Upon findings of fact made by the referee, all of the adventurers were held liable to make good the losses which the purchasers of the shares, including the Boston director, himself innocent of their machinations, had sustained.[2]

519. A useful review of the decisions on this question was contributed to a legal publication called *The Advocate*, by Dr. Bailey, of North Carolina. 1 Adv. 389, *et seq.*

[1] Bedford *v.* Bagshaw, 4 Hurl. & N. 538; *s. c.* 29 L. J. (Exch.) 59. This case the reader must be reminded has been overruled by the House of Lords in Peck *v.* Gurney (see note to preceding section); but we apprehend that it is a good illustration of what remains the law of this country.

[2] Hornblower *v.* Crandall, 7 Mo. App. 220; *s. c.* affirmed, 78 Mo. 581; Watson *v.* Crandall, 7 Mo. App. 233; *s. c.* affirmed, 78 Mo. 583; Baker *v.* Crandall, 7 Mo. App. 564; *s. c.* affirmed, 78 Mo. 584. The writer of this work tried these cases as referee. Very few trials have taken place which have more conspicuously exhibited the value

§ 1474. Liability of Co-adventurers for Each Others' Frauds. — Where several persons engage in business jointly, and, to facilitate such business, use a corporate name and issue stock, and, in the promotion of the scheme, false representations are made by those holding themselves out as promoters and managers of the business as to the material facts of inducement and as to matters peculiarly within the knowledge of all the associates or their agents, all those engaged in the promotion of the business as associates of those making the false representations are liable to those who, relying upon such representations, purchase stock to their hurt.[1]

§ 1475. Liability of the Co-adventurers for the Frauds of the Agent Employed by Them. — In such a case as that stated in the last preceding section, all the co-adventurers will be liable, on the principle of *respondeat superior*, in damages for the consequences of the fraud of the agent whom they have employed to effect the sale of the shares, without reference to the question of their own moral guilt or innocence. The grounds on which this liability rests were well stated in the opinion of the St. Louis Court of Appeals, affirmed by the Supreme Court of Missouri: "Promoters of companies are not, indeed, merely as such, each other's agents, or liable for each other's acts. It was formerly held that persons engaged in establishing companies were partners, as they were acting together for a common object with a view of sharing gains; but such is not now the accepted doctrine.[2] An association for forming a company is not necessarily a partnership, and the question is whether there is a basis of fact for the legal implication of agency. The

of skillful, close and unremitting professional work in behalf of the party sustaining the burden of proof. The leading counsel for the plaintiffs was Edmund T. Allen, Esq., of St. Louis. The final result, which ended in the recovery by the plaintiffs or their personal representatives of the amounts which they had lost in consequence of this ably contrived and prosecuted scheme of fraud, was due almost entirely to his professional skill and perseverance. The money was finally collected out of the only one of the co-adventurers who was morally innocent, on the ground stated in the two succeeding sections.

[1] Hornblower *v.* Crandall, 7 Mo. App. 220; *s. c.* affirmed, 78 Mo. 581.

[2] Citing Lindl. Part., edition of 1878, pp. 31, 54, 240.

principal is liable for the torts of his agents committed in the course of the principal's business. It is no defense that the principal has not authorized the deceit, if it is committed in the matter intrusted by the principal to his agent. Where the deceitful contrivance is for the principal's benefit and done in the course of his business, the question, at its best, is, who of two innocent parties shall suffer? And the rule is, as it ought to be, that he who has put his trust in the wrong-doer, and held him out to the world as a person to be dealt with, shall bear the burden of his acts.[1] The rule has here a direct application, as there was at first, not merely a number of persons pursuing a scheme in concert, with a view to a future object, but persons engaged in actual business together, each taking more or less part in the concern. The fact that they afterwards used, as a means to advance the business, the corporate form, and manipulated shares of stock, cannot shield them from the legal consequences of their joint action. All of the defendants did something toward the common end; and in what McKeen did not directly do, he trusted, as he says, to the judgment of Crandall and Conlogue, in whom he confided, and to his partner, Minshall. If, with the means of knowledge at hand, an associate thus connected, either through design or carelessness, abstains from knowing, and leaves details to his companions, while the illicit gains go to the common account, his ignorance ought not to avail him. The law would be helpless if its applications could be avoided by this convenient ignorance. Where the parties sought to be charged might have known, and where it can fairly be inferred that they, with the wrong-doers, received the benefit of the contrivance, their ignorance cannot avail them."[2]

[1] Citing Locke *v.* Stearns, 1 Metc. (Mass.) 560; White *v.* Sawyer, 16 Gray (Mass.), 586; Barwick *v.* English &c. Bank, L. R. 2 Exch. 259; Mackay *v.* Commercial &c. Bank, L. R. 5 P. C. 394; Swift *v.* Jewsbury, L. R. 9 Q. B. 301; St. Aubyn *v.* Smart, L. R. 5 Eq. 183.

[2] Hornblower *v.* Crandall, 7 Mo. App. 220, 230; opinion by Hayden, J.; *s. c.* affirmed, 78 Mo. 581. To the last point the learned judge, who wrote the opinion of the intermediate appellate court, cited: Simons *v.* Vulcan &c. Co., 61 Pa. St. 202; Castle *v.* Bullard, 23 How. (U. S.) 189; Vreeland *v.* New Jersey &c. Co., 29 N. J. Eq. 195; Chester *v.* Dickerson, 54 N. Y. 1.

§ 1476. The Fraudulent Representation must have been a Material Inducement to the Contract. — Moreover, the fraudulent misrepresentation must have been a *material inducement* to the act of the plaintiff in purchasing the shares.[1] This is perfectly obvious upon principle. There would be neither sense nor justice in requiring a person to pay damages for a wrong which did not produce the injury complained of. But this does not mean that the fraudulent representations should have been the *sole inducement* to the act of the plaintiff in purchasing the shares.[2] If A. is guilty of a negligent act and B. is guilty of another negligent act, and these two acts combining together, result in an injury to C., C. may maintain an action either against A. or B.[3] It is obvious that this principle is just as applicable where the act or acts, which resulted in the injury, were fraudulent misrepresentations, as where they were negligent omissions. We have no doubt that if the directors of a company were to put forth a false and fraudulent prospectus, and it should be seen and read by A., and a broker should falsely make the same representations to A., as of his own knowledge, A. would have an action for damages either against the directors, or against the broker; and it has been in effect, so held.[4] It has been held that a director of a corporation is not liable to one who has purchased its shares on the faith of certain false statements contained in the articles of association, because these necessarily preceded in order of time the election of the board of directors, and

[1] *Ante*, § 1384; *post*, § 1505.

[2] Morgan *v.* Skiddy, 62 N. Y. 319; affirming *s. c.* 4 Jones & Sp. (N. Y.) 152. This is a general principle in the law of fraud. Arthur *v.* Griswold, 55 N. Y. 400.

[3] Burrows *v.* March Gas and Coke Co., L. R. 5 Exch. 67; *s. c.* L. R. 7 Exch. 96; 2 Thomp. Neg. 1070; Eaton *v.* Boston &c. R. Co., 1 Allen (Mass.), 500; Illidge *v.* Goodwin, 5 Car. & P. 190; Lynch *v.* Nurdin, 1 Q. B. 29; Lockhart *v.* Lichtenthaler, 46 Pa. St. 151; *s. c.* 84 Am. Dec. 479; McCahill *v.* Kipp, 2 E. D. Smith (N. Y.), 413; Peck *v.* Neil, 3 McLean (U. S.) 26; Smith *v.* Dobson, 3 Scott, N. R. 336; Congreve *v.* Morgan, 18 N. Y. 84; *s. c.* 72 Am. Dec. 495; Irwin *v.* Fowler, 5 Robt. (N. Y.) 482; Ricker *v.* Freeman, 50 N. H. 420; Wheeler *v.* Worcester, 10 Allen (Mass.), 591; Chapman *v.* New Haven &c. R. Co., 19 N. Y. 341; Colgrove *v.* New York &c. R. Co., 20 N. Y. 492; Barrett *v.* Third Av. R. Co., 45 N. Y. 628; McMahon *v.* Davidson, 12 Minn. 357; Griggs *v.* Flickenstein, 14 Minn. 81, 93; Philadelphia *v.* Weller, 4 Brewst. (Pa.) 24; Carpenter *v.* Central Park R. Co., 11 Abb. Pr. (N. S.) 416.

[4] Morgan *v.* Skiddy, 62 N. Y. 319; affirming 4 Jones & Sp. (N. Y.) 152.

they could not have the character of a continuing false statement by every director who might subsequently come into the board.[1]

§ **1477. Views of Vice-Chancellor Wood.** — This subject was carefully considered by Sir W. Page Wood, V. C. (afterwards Lord Hatherley), in a suit in equity, the object of which was to charge both the company and the directors for a fraud of this nature; and, after disposing of the case against the company, he stated that the liability of the directors was governed by the following principles: 1. Every man must be responsible for the consequences of a false representation made by him to another, upon which that other acts, and, so acting, is injured or damnified. 2. Every man must be held responsible for the consequences of a false representation made by him to another, upon which a third person acts, and, so acting, is injured or damnified; provided it appear that such false representation was made with the intent that it should be so acted upon by such third person in the manner that occasions the injury or loss.[2] 3. But the injury must be the immediate, and not the remote consequence of the representation thus made. To render a man responsible for the consequences of a false representation made by him to another, upon which a third person acts, and, so acting, is injured or damnified, it must appear that such false representation was made with the direct intent that it should be acted upon by such third person in the manner that occasions the injury or loss.[3] This last proposition, as the reader must already have concluded, from what precedes, is not the law.

§ **1478. If the Purchaser Relied on the Misrepresentations, Immaterial that He Made Other Inquiries.** — In such a case, if it is found as a fact upon evidence that the purchaser relied upon the misrepresentations of the promoters or directors, it is not an objection to his right to recover of them on the ground of

[1] Mabey *v.* Adams, 3 Bosw. (N. Y.) 346.

[2] Upon this point, he aptly cited Langridge *v.* Levy, 2 Mees. & W. 519.

[3] Barry *v.* Croskey, 2 Johns. & Hem. 1, 25.

deceit, that he made inquiries in other directions; provided that it may fairly be inferred that his main and substantial reliance was upon what these defendants said and did.[1]

§ 1479. Opinions Mingling with Fraudulent Misrepresentations of Fact. — "Nor is it material that, with the fraudulent representations as to matters of fact, many expressions of opinion were mingled which would have afforded no ground of action."[2]

§ 1480. Right of Purchaser to Rely upon the Representations. — "Persons investing in stock, under circumstances like the present,[3] have a right to confide in those who hold themselves out as the promoters and managers of a business which they are carrying on, so far as concerns representations made by such promoters, or under their authority, as to material facts of inducement peculiarly within the knowledge of the associates or their agents."[4]

§ 1481. Analogy of the Rule Applied in Actions for Rescission.— Under this head we may derive important aid from the conclusion which the courts have reached in a class of cases where the defrauded shareholder, instead of bringing an action for deceit against the directors who perpetrated the fraud, brought an action against the company for a rescission of the contract, or set up the fraud as a defense to actions against them for calls. In these cases it must appear that the sharetaker entered into the contract of subscription on the faith of the statements complained of.[5]

§ 1482. Company with Wider Powers than those Named in the Prospectus.— When a person has subscribed for shares in a company on the faith of a prospectus making certain representations, and on examining the memorandum which subscribers

[1] Hornblower *v.* Crandall, 7 Mo. App. 220, 232; *s. c.* affirmed, 78 Mo. 581.

[2] Hornblower *v.* Crandall, 7 Mo. App. 220, 233; *s. c.* affirmed, 78 Mo. 581.

[3] The investors were residents of a distant State. See *ante*, § 1370 *et seq.*

[4] Hornblower *v.* Crandall, 7 Mo. App. 220, 232, opinion by Hayden, J.; *s. c.* affirmed, 78 Mo. 581.

[5] *Ante*, § 1384, *et seq.*

are required to sign, finds that it contains provisions materially different from those stated in the prospectus, he is entitled to claim a cancellation of his subscription, on the ground that the company tendered to him one kind of a contract, and then required him to execute another: he agreed to become a member of a particular kind of company, and they proposed to make him join a different kind of company. If, in such a case, he has advanced moneys to the company by way of deposits or payment of his shares, he may, of course, claim to have the same refunded to him; and if the company fails or refuses to refund such moneys, he may maintain an action therefor against the company, so long as the company continues a "going concern;" and if the company is ordered to be wound up, he may prove his claim against the company and take his distributive share with the other creditors.[1] But he cannot, on the mere ground that the memorandum of association creates a company with wider powers than those named in the prospectus, charge the directors personally for the moneys which he has thus advanced, if this falls short of actual fraud.[2]

§ 1483. **Jurisdiction of Law and Equity Concurrent.**— It is clear upon authority that, in those cases where it is sought to recover of directors, damages which a person has sustained in consequence of having been induced by their fraud to take shares in their company, the courts of equity exercise a jurisdiction concurrent with that of the courts of law. Hence, the fact that a person defrauded in this manner has a remedy at law, does not oust the jurisdiction of equity to afford him relief.[3]

§ 1484. **Advantage of Resorting to Equity.** — The only advantage of going into equity with such a suit, seems to be to obtain a more ample remedy. In an action at law for deceit, the plaintiff can only recover the damages he has suffered. But in equity he may claim (1), a cancellation of his subscription; (2)

[1] Ship *v.* Crosskill, L. R. 10 Eq. 73, 83.

[2] *Ibid.* Stewart *v.* Austin, L. R. 3 Eq. 299.

[3] Stainbank *v.* Fernley, 9 Sim. 558; Seddon *v.* Connell, 10 Sim. 59; Barry *v.* Croskey, 2 Johns. & Hem. 1; Peek *v.* Gurney, L. R. 6 H. L. 377; Leffman *v.* Flanigan, 5 Phila. 155; *ante*, § 1425.

a decree against the directors jointly and severally for the repayment to him of all the moneys paid for the shares; and (3) an injunction against future calls. To such a suit, of course the corporation is a party.[1]

§ 1485. View that Grounds of Relief are the Same at Law and in Equity. — In giving relief in these cases *against the directors and officers* the courts of law and the courts of equity proceed, according to the highest authority, upon the same grounds. "There can be no doubt," says Lord Chelmsford, "that equity exercises a concurrent jurisdiction in cases of this description, and the same principles applicable to them must prevail both at law and in equity."[2] The previous discussion has suggested what these grounds are: 1. False representations; 2. A guilty *scienter;* 3. Proximate damage to the plaintiff.[3] "If you do not fix them with what is technically called a *scienter* upon an action of deceit, you cannot fix them personally with the consequences of the injury or damage that may result to the plaintiff who has been so deceived."[4] Another judge has said that in such a case

[1] Directors *v.* Kisch, L. R. 2 H. L. 99; Waldo *v.* Chicago &c. R. Co., 14 Wis. 575; Henderson *v.* Railroad Co., 17 Tex. 560; *s. c.* 67 Am. Dec. 675; The State *v.* Jefferson Turnpike Co., 3 Humph. (Tenn.) 305; Ashmead *v.* Colby, 26 Conn. 287; Ross *v.* Estates Investment Co., L. R. 3 Ch. 682; affirming *s. c.* L. R. 3 Eq. 122; Rawlins *v.* Wickham, 3 DeG. & J. 304; Henderson *v.* Lacon, L. R. 5 Eq. 249; Smith *v.* Reese River Co., L. R. 2 Eq. 263; *s. c.* L. R. 4 H. L. 64; Thorpe *v.* Hughes, 3 Myl. & Cr. 742; Askew's Case, L. R. 9 Ch. 664; Cargill *v.* Bower, 10 Ch. Div. 502.

[2] Peek *v.* Gurney, L. R. 6 H. L. 377; *s. c.* Thomp. Off. Corp. 309.

[3] Barry *v.* Croskey, 2 Johns. & Hem. 1; Henderson *v.* Lacon, L. R. 5 Eq. 249.

[4] Sir W. Page Wood, V. C., in Henderson *v.* Lacon, *supra.* The application of this doctrine made by this learned judge is as interesting as the doctrine itself. He said: "In this instance it appears to me that the *scienter* is clearly fixed upon the directors, from the moment you find a representation concerning their own acts which is incorrect, and which they must be taken to have known to be incorrect, and to have knowingly stated, and thereby to have misled the party complaining of the misrepresentation. I must say I think the result of all the cases which have occurred shows the great value of that golden legacy, if I may so term it, which has been left to us by Sir Richard Kindersley, who has condensed in a few words the whole doctrine as to the rule of conduct between shareholders and their directors, in the case of the New Brunswick and Canada Railway Company *v.* Muggeridge (1 Dr. & Sm. 363), and cited with approbation in the case of the Central Railway Company of Venzuela *v.* Kisch (L. R. 2 H. L. 113), in the House of Lords." L. R. 5 Eq. 262.

the chancellor cannot make any other inquiry than this: "Were the representations willful, false and fraudulent?"[1] And upon this ground he ruled that a director of a company is not liable for a fraud of this nature committed by his co-directors, or by any other agent of the company, although guilty of gross negligence, unless there was an intention to allow of the commission of the fraud.[2]

§ 1486. **American Opinion on this Subject.** — A very learned American judge has said that the rule in equity is so far different from that at law that there are many cases in which a party will not be allowed to refuse redress to another whom he has misled by unfounded assurances, on the ground that he spoke ignorantly and was free from intentional wrong.[3] "The line of demarkation," continued he, "between those instances in which good faith will, and those which it will not excuse, is obscure and ill-defined, although the authorities show that it should be so drawn as to distinguish assurances officiously pressed upon others, and intended to induce the adoption of a particular course of action, from statements made with an honest desire to impart the information for which another has asked.[4] The representation under these circumstances partakes of the nature of a contract and will be specifically enforced by equity as a means of giving a relief which could not be attained at law."[5] Notwithstanding the respect which is due to the judge who delivered the above observations, we apprehend that they confuse the rules applicable to those cases where the complainant is proceeding to recover from the defendant the money which *he* has obtained from the plaintiff by making representations which proved to be untrue, and cases where the complainant is prosecuting against the directors a suit in the nature of an action at law to recover of the directors personally the *damages* which he has sustained

[1] Cargill *v.* Bowyer, 10 Ch. Div. 502, 516, Fry, J.

[2] *Ibid.*

[3] Citing 2 Story Eq. Jur., § 387; Warner *v.* Daniels, 1 Woodb. & M. (U. S.) 91, 107; Miner *v.* Medbury, 6 Wis. 295.

[4] Citing 2 Story Eq. Jur., §§ 193, 387; McKelvey *v.* Truby, 4 Watts & S. (Pa.) 323; Beaupland *v.* McKeen, 28 Pa. St. 124, 131; *s. c.* 70 Am. Dec. 115; Willis *v.* Swartz, *Ibid.* 413; Elliot *v.* Callan, 1 Pa. Rep. 24; Wells *v.* Pierce, 27 N. H. 503.

[5] Hare, J., in Leffman *v.* Flanigan, 5 Phila. (Pa.) 155.

in consequence of being induced by their false representations to part with his money *to the corporation.* In the one case, the defendant has got the plaintiff's money, and ought not to be permitted to keep it even where the fraud is unintentional and constructive. In the other case, another party has got it through his misrepresentations; and whether he should pay damages for this, ought, it should seem, to depend upon the measure of duty he was under to the plaintiff — whether he stood as a warrantor of the truth of what he said, or whether he was bound merely to exercise a reasonable care and an honest fidelity, not to say that which was not true. We therefore think that the English judges express the rule more correctly; and moreover that they are right in holding that, in the class of actions we are considering, the rule of liability is the same in equity as at law. For it cannot be that where, as in this case, the courts of law and equity exercise a concurrent jurisdiction, there is one rule of right administered in one court, and a different rule of right administered in the other. This would be equivalent to saying that there are two kinds of law in the same country on the same subject, a thing which would be intolerable.[1] It is to be feared, however, that it cannot be affirmed that such is the law in America. It is believed that our American jurisprudence must, for some time to come, submit to the scandalous imputation that, in respect of what is honest and what is dishonest — a matter cognizable by all men — even savages — there are different and irreconcilable rules, depending in some States upon the court in which the action is brought — whether it be what is called a court of law or what is called a court of equity — and depending in other States on the form of the action — whether it be what is termed an action at law or what is termed a suit in equity.

§ 1487. Action against both Directors and Managers. — There is no obstacle to bringing an action of this kind both

[1] In an article in the April number, 1880, of the *American Law Review*, by Hon. James V. Campbell, of Michigan, every line of which is full of thought, that able judge says: "In those States which retain the distinctions between law and equity, the difference is generally one of *remedies;* and legal and equitable suits differ only as actions of assumpsit differ from ejectment or replevin." 1 Am. L. Rev. (N. S.) 265.

against the directors and managers, if both concurred in the fraud. For "all persons directly concerned in the commission of a fraud are to be treated as principals. No party can be permitted to excuse himself on the ground that he acted as the agent, or as the servant of another; and the reason is plain, for the contract of agency or of service cannot impose any obligation on the agent or servant to commit, or assist in the committing of a fraud."[1]

ARTICLE VI. FRAUDULENT ISSUES AND OVERISSUES.

§ 1490. Constitutional Provisions. — Constitutional provisions on the subject under consideration are found in several of the newer States, among them the following: No corporation shall issue stocks or bonds, except for labor done, services performed, or money or property actually received, and all fictitious increase of stock or indebtedness shall be void. The stock of corporations shall not be increased except in pursuance of general law, nor without the consent of the persons holding a majority of the stock, first obtained at a meeting held

[1] Cullen *v.* Thompson, 4 Macq. H. L. (Sc.) 424; *s. c.* 2 Pat. Sc. App. 143.

after at least thirty days' notice given in pursuance of law.[1] - - - - No corporation shall issue stocks or bonds except for labor done, services performed, or money and property actually received; and all fictitious increase of stock or indebtedness shall be void. The stock of corporations shall not be increased except in pursuance of general law, nor without the consent of the persons holding a majority of the stock first obtained at a meeting held after at least thirty days' notice given in pursuance of law.[2] - - - - Corporations shall not issue stock, except to *bona fide* subscribers therefor, or their assignees; nor shall any corporation issue any bond, or other obligation, for the payment of money, except for money or property received or labor done. The stock of corporations shall not be increased, except in pursuance of a general law, nor shall any law authorize the increase of stock, without the consent of the person or persons holding the larger amount in value of the stock, nor without due notice of the proposed increase having been previously given in such manner as may be prescribed by law. All fictitious increase of stock or indebtedness shall be void.[3]

§ 1491. Gratuitous Donees of Fictitious Stock not Shareholders. — Under such a constitutional provision as those just cited, and a statute embodying the same prohibition,[4] which declares that no corporation shall issue stock except for labor done, services performed, or money or property actually received, and all fictitious increase of stock shall be void, persons to whom stock is issued, for which they do not pay or agree to pay anything, do not thereby become shareholders of the corporation in any sense, and cannot sue as such.[5]

§ 1492. Neither are Subscribers to Fraudulent Overissues. — Aside from constitutional and statutory provisions, such as those just set out, it is the law that a subscription to the stock of a corporation, after the entire amount authorized by law has been taken, is wholly void; for statutory limitations upon the amount of capital to be raised would be of no avail if they were allowed thus to increase their capital at pleasure.[6]

[1] Const. Idaho, 1889, Art. XI, § 9.

[2] Const. Montana, 1889, Art. XV, § 10.

[3] Const. Wash. 1889–90, Art. XII, § 6.

[4] Const. Colo., art. 15, § 9, which has been embodied in Gen. St. Colo., §§ 251, 340.

[5] Arkansas River Land &c. Co. *v.* Farmers' Loan &c. Co., 13 Colo. 587; *s. c.* 22 Pac. Rep. 954.

[6] New York &c. R. Co. *v.* Schuyler, 34 N. Y. 30; *ante*, § 1251.

Such a subscriber is not liable on his subscription.[1] And it has been held, in a suit on a subscription for shares in a corporation, where the amount of stock was fixed by the charter at a certain limit, but with the proviso that additional stock might be issued when the president and directors should direct, that the fact that the whole amount of original stock had been issued, and that the issue of additional stock had not been directed by the officers of the company, would furnish a good defense.[2]

§ 1493. But Bona Fide Subscriber or Purchaser of Shares may Sue Corporation for Re-imbusement. — But while the subscriber or purchaser of shares of stock which the corporation has no power to issue cannot be admitted to the rights nor held to the liabilities of a shareholder,[3] yet it does not follow that he has no remedy against the corporation which is answerable for the fraud. If he has paid out money on the faith of the certificates being lawfully issued, he may maintain an action against the corporation for re-imbursement.[4]

§ 1494. Reason of the Rule. — The rule rests upon the principle that the act of the corporation, through its officers, of issuing spurious certificates of stock, when accepted and acted upon by another in good faith, *estops* the corporation from denying its liability to the *bona fide* taker of the shares, for the loss which he has thereby sustained. It proceeds upon the principle that stock certificates issued by a corporation constitute a *continuing affirmation*, by the corporation to the public, that the person named therein is the owner of the number of shares of the corporation therein stated, upon which an intended purchaser

[1] Clark *v.* Turner, 73 Ga. 1.

[2] McCord *v.* Ohio &c. R. Co., 13 Ind. 220. In such a case an *averment* in the answer of the subscriber to the general effect that the overissue was fraudulent has been held insufficient: the pleader should allege the particular circumstances of the fraud. *Ibid.*

[3] *Ante*, §§ 1251, 1492.

[4] Schuyler *v.* New York &c. R. Co., 34 N. Y. 30; Titus *v.* Great Western Turnpike Road, 61 N. Y. 237 (spurious certificate); Willis *v.* Fry, 13 Phila. (Pa.) 33; Kisterbock's Appeal, 127 Pa. St. 601; *s. c.* 14 Am. St. Rep. 808; 24 W. N. C. 446; 18 Atl. Rep. 381. Compare Cartwright *v.* Dickinson, 88 Tenn. 476; *s. c.* 7 L. R. A. 706; 12 S. W. Rep. 1030.

of such shares has the right to rely, in the absence of notice or knowledge to the contrary.[1]

§ 1495. How Liable for Fraudulent Issues which are not Overissues. — On the ordinary rule of *respondeat superior*[2] a corporation is liable to one who has been defrauded by the act of its transfer clerk in issuing a certificate of its stock to a fictitious person, and so getting it in circulation.[3] If the certificate thus fraudulently issued by its agent does not exhaust its potential stock and create an overissue, it is bound to specifically perform the representation thus made by the certificate thus issued, and to admit an innocent purchaser to the rights of a shareholder.[4]

§ 1496. No Right to have such Certificates Cancelled. — Nor can the corporation maintain a suit in equity to restrain the transfer of the certificate in such a case and compel its surrender, but it will be *estopped* from denying its validity.[5] Even supposing there may be, in a given case, a right of cancellation, the failure by the corporation or its stockholders to take *prompt action* to procure the cancellation of stock claimed to be fraudulently issued, will be deemed a *ratification* thereof by the corporation.[6]

§ 1497. But Overissued Shares Cancelled and Dividends Enjoined. — But overissued shares being void, the holder of

[1] Kisterbock's Appeal, 127 Pa. St. 601; *s. c.* 14 Am. St. Rep. 868; 24 W. N. C. 446; 18 Atl. Rep. 381; Keller *v.* Eureka Brick Co., 43 Mo. App. 84, 87.

[2] *Post*, Ch. 137.

[3] Jarvis *v.* Manhattan Beach Co., 6 N. Y. Supp. 703; *s. c.* 53 Hun (N. Y.), 362.

[4] Thus, it has been held that where a corporation permits its agent to sell stock covered by certificates, when there is stock standing to its credit sufficient to cover such certificates, it is bound to make them good to the extent of any shares owned by the company within the limit of its capital stock, and such unsold shares should be applied to the satisfaction of the oldest outstanding certificate of that character. New York &c. R. Co. *v.* Schuyler, 38 Barb. (N. Y.) 534.

[5] Manhattan Beach Co. *v.* Harned, 23 Blatchf. (U. S.) 494; *s. c.* 27 Fed. Rep. 484. Circumstances under which a corporation not estopped from recovering damages from its own treasurer for fraudulently issuing a certificate of its stock: Brooklyn &c. R. Co. *v.* Strong, 75 N. Y. 591. Circumstances under which the defrauded sharetaker not estopped from maintaining a bill for a rescission: Snow *v.* Weber, 39 Mich. 143.

[6] American Wire-Nail Co. *v.* Bayless 91 Ky. 94; *s. c.* 15 S. W. Rep. 10.

them cannot be admitted to the rights of a shareholder to the prejudice of the holders of genuine shares, and the latter may have an action in equity to *cancel* such spurious shares,[1] or to enjoin the corporation from paying dividends thereon, or from making any future dividend until it is ascertained who are the genuine shareholders.[2] The corporation is an indispensable *party* to such an action for the cancellation of spurious shares,[3] and the same may be assumed as to such an action for an injunction. Equitable circumstances may, of course, intervene to prevent such a cancellation; and, as a spurious issue does not invalidate the original stock, the relief cannot extend so far as the cancellation of *all* the stock.[4]

§ **1498. Distinction Between Fraudulent Overissues Made by an Agent for His own Benefit and those Made by Him while Acting for the Corporation.** — Some have supposed that there is room for a distinction between the case where the fraudulent overissue is made by an agent of the corporation — say its secretary or treasurer — while dealing for himself, and the case where its certificates are issued in the course of the business of the corporation. To illustrate a case of the first kind, let us suppose that an officer issues a certificate to himself, or to a confederate in crime, and it is passed to a *bona fide* holder, who brings an action for damages against the corporation. In one theory, there is no liability here, because the act done was neither within the actual nor the apparent scope of the agent's authority. According to this view, the instrument being non-negotiable — and as to this all the authorities agree — the buyer takes the title of the seller.[5] To illustrate a case of the second kind, let us suppose a case where the officer of the corporation may himself be engaged in a scheme of fraud, where the persons defrauded are dealing *with the corporation* through him, in

[1] Campbell *v.* Morgan, 4 Ill. App. 100.

[2] Underwood *v.* New York &c. R. Co., 17 How. Pr. (N. Y.) 537. *S. P.*, Carpenter *v.* New York &c. R. Co., 5 Abb. Pr. (N. Y.) 277.

[3] Campbell *v.* Morgan, *supra.*

[4] Byers *v.* Rollins, 13 Colo. 22; *s. c.* 21 Pac. Rep. 894.

[5] Such was the case of Mechanic's Bank *v.* New York &c. R. Co., 13 N. Y. 599. (Overruled on most points, it is thought, by New York &c. R. Co. *v.* Schuyler, 34 N. Y. 30.)

which dealing they innocently receive the spurious certificates from him. In such cases there is a liability on the part of the corporation, because corporations are liable as natural persons are, for the acts of their agents done in the course of their employment, and within its apparent scope. Such was a celebrated case in New York where there were many fraudulent overissues of the stock of a railway company, by one Schuyler, who was at once a director, the president, and the agent of the corporation in the city of New York to effect transfers of its stock. In this character he had control of its stock ledger and other books for a course of years, during which time he issued much stock, genuine and spurious. Finally he made a confession to the board of directors, tendering at the same time his resignation. It was held that the corporation was liable in damages to the *bona fide* holders of such spurious stock certificates.[1] The persons defrauded by him did not deal with him personally, but they dealt with him as agent of the corporation; in other words, they dealt with the corporation through him. In a later case in New York the court seems to have assumed that the case just cited overruled the case in the same State previously cited, — at least the decision necessarily involves that conclusion;[2] and this decision led two other courts to decisions which some, proceeding on this supposed distinction, have regarded as erroneous, but which the author regards as sound.[3]

§ 1499. Illustrations of this Distinction: Loss Falling on the Sharetaker. — This distinction is illustrated in a case in the Supreme Court of the United States, where the cashier of a national bank borrowed money of the plaintiff *for his own personal use*, to secure which he falsely represented to her that he owned and had transferred to her a certificate of the stock of the bank to an amount equal to the amount loaned. In pursuance of this representation, he delivered to her a certificate, written by him on one of the printed forms of certificates in use by the corporation, which had been signed in blank by the president and left with him to be used by him, if necessary, in the president's

[1] New York &c. R. Co. *v.* Schuyler, 34 N. Y. 30.

[2] Titus *v.* Great Western Turnpike Co., 61 N. Y. 237.

[3] Willis *v.* Fry, 13 Phila. (Pa.) 33; Tome *v.* Railway Co., 39 Md. 36; *s. c.* 17 Am. Rep. 540.

absence. This certificate, as thus filled out by the cashier, certified that the plaintiff was the owner of a certain number of shares of the capital stock of the bank, "transferable only on the books of the bank on the surrender of this certificate." The by-laws of the bank provided that transfers of the stock of the bank could only be made on its books on the surrender of the certificates. The cashier did not transfer. The cashier surrendered no certificate to the bank, made no transfer on the books of the bank, never repaid the money loaned, and became insolvent. The bank never ratified nor received any benefit from the transaction. It was held that the plaintiff could not maintain an action against the bank to recover the value of the certificate. In giving the opinion of the court Mr. Justice Gray said: "The very form of the certificate was such as to put her upon her guard. She was not applying to the bank to take stock, as an original subscriber or otherwise; but she was bargaining with Robert B. Moores for stock which she supposed him to hold as his own. She knew that she had not held or surrendered any certificate, and she never asked to see his certificate or a transfer thereof to her; and he in fact made no surrender to the bank or transfer on its books. She relied on his personal representation, as the party with whom she was dealing, that he had such stock; and she trusted him as her agent to see the proper transfer thereof made on the books of the bank. Having distinct notice that the surrender and transfer of a former certificate were prerequisites to the lawful issue of a new one, and having accepted a certificate that she owned stock, without taking any steps to assure herself that the legal prerequisites to the validity of her certificate, which were to be fulfilled by the former owner and not by the bank, had been complied with, she does not, as against the bank, stand in the position of one who receives a certificate of stock from the proper officers without notice of any facts impairing its validity."[1] - - - - In a case in Pennsylvania it appeared that A., the president of a street railroad company, by fraudulently representing to B., his aunt, that a loan of her shares of the company's stock was needed by the company, induced her to part with them. He immediately pledged them for his own debt. The company paid her interest on the shares for some time. A. conspired with other officers of the company to procure a fraudulent overissue of stock, some of which he transferred to B. in lieu of her own. It was held that this stock was worthless in B.'s hands, and that as A. had acted, in obtaining her stock, as *her agent*, and not as the agent of the company, the loss of her stock must fall on her, and not on the company.[2]

[1] Moores *v.* Citizens' National Bank, 111 U. S. 156, 165.

[2] Wright's Appeal, 99 Pa. St. 425.

§ 1500. Doctrine that Fraudulent Certificates are not Misrepresentations to the General Public.— In a case where the agent of a corporation authorized to issue its certificate of shares made a fraudulent overissue and imposed the fraudulent certificates through the collusion of a third person upon an innocent public, the Court of Appeals of New York held that the corporation was not answerable to the members of the public thus defrauded for the reason (among others) that the case fell within the maxim relating to the law of estoppel that an admission or representation is no estoppel in favor of a stranger to whom it is not made and whose conduct it is not expressly designed to influence. This is indeed the general principle; [1] and the court, in applying it to the case of a fraudulent overissue of stock certificates, said, in its opinion given by Comstock, J.: "The result is, that before the principles of estoppel can be applied to this controversy, it must be asserted and proved that a certificate of stock, differing from all other modes and forms of obligation used in the transactions of men, contains within itself a representation or admission of facts which any dealer however remote from the original parties, may accept as addressed to himself and intended to influence his conduct. For such a doctrine no authority has been cited, and it has no foundation in any principle hitherto recognized." [2] Notwithstanding this language it is believed that the courts have gone far enough to establish a rule precisely the contrary to that which the learned judge asserts and that among these courts is the Court of Appeals of New York in later cases. That court has held, in respect of fraudulent representations made by merchants to mercantile agencies respecting their solvency, whereby members of the public generally have been influenced to give credit to such merchants to their injury, that the *mercantile agencies* have become such well recognized instruments of commerce that the courts will take judicial notice of the fact, well known by the whole business community throughout the country, that their principal office is to collect

[1] Pennell *v.* Hinman, 7 Barb. (N.Y.) 644; Reynolds *v.* Lounsbury, 6 Hill (N. Y.), 534; Bezell *v.* Odell, 3 *Id.* 215; *s. c.* 38 Am. Dec. 628; Jackson *v.* Brinkerhoff, 3 Johns. Cas. (N. Y.) 101.

[2] Mechanics' Bank *v.* New York &c. R. Co., 13 N. Y. 599, 638; reversing *s. c.* 4 Duer (N. Y.) 480.

information concerning the financial standing of merchants and other business men, which they communicate upon request to other merchants or business men who may have occasion to extend credit to a customer.[1] That court and other courts have also held it to be a sound proposition that, since a merchant or business man who makes statements to such a mercantile agency touching his financial standing, does so with the knowledge that the parties for which the agency obtains this information is to communicate it to other merchants and business men from which the former may solicit credit, the merchant so giving the information to the agency occupies precisely the same position in law towards any one who is deceived thereby into giving him credit, as though he had made the communication to the other merchant direct.[2] And this holding is but the application of the general rule laid down and applied in many other cases, which is, that a person who makes a false statement for the purpose of deceiving and entrapping any one of a particular class of persons whom it may catch, is responsible for the consequences of such false statement to any one whom it does chance to catch.[3] If then the agent of a corporation empowered to make representations upon a given subject, makes, for the purpose of effecting some purpose of his own, a false representation upon that subject, which false representation assumes the form of a written obligation of the corporation, such as, by the known course of business when indorsed in a certain way, circulates in the markets of the world from hand to hand upon the faith of the signature of such agent of the corporation, no principle is perceived why such a paper should not be deemed a false representation made by such agent to any member of the public who may chance to be injured thereby. It is believed

[1] Eaton &c. Co. *v.* Avery, 83 N. Y. 31; *s. c.* 38 Am. Rep. 389.

[2] Eaton &c. Co. *v.* Avery, *supra;* Genesee Co. Savings Bank *v.* Michigan Barge Co., 52 Mich. 164; Lindauer *v.* Hay, 61 Ia. 664; Holmes *v.* Harrington, 20 Mo. App. 661, 669.

[3] Ayre's Case, 25 Bevan, 513; Wontner *v.* Shairp, 4 C. B. 404; Davidson *v.* Tulloch, 1 Macq. H. L. Cas. 783; *s. c.* 6 Jur. (N. S.) 543; Bartholomew *v.* Bentley, 15 Oh. 659; *s. c.* 45 Am. Dec. 596; Cazeaux *v.* Mali, 25 Barb. (N. Y.) 578, 583; Cross *v.* Sackett, 2 Bosw. (N. Y.) 618; Clarke *v.* Dickson, 6 C. B. (N. S.), 453; Bedford *v.* Bagshaw, 4 Hurl. & N. 538; *s. c.* 29 L. J. (Exch.) 59; Scott *v.* Dixon, 29 L. J. (Exch), 62 n; Morgan *v.* Skiddy, 62 N. Y. 319; *ante*, § 1472.

that the rule in respect of the rights of subsequent purchasers in good faith of fraudulently issued shares is now settled in conformity with this principle, not only in New York,[1] but elsewhere, that a certificate of corporate stock being a continuing affirmation by the corporation to the commercial world that the person named therein is entitled to the number of shares of stock of the company therein named, if it has been issued in fraud of the rights of the corporation by its agent authorized to issue shares, the corporation must make it good either by way of specific performance or damages, accordingly as it was an issue within the powers of the corporation or an overissue beyond its powers.[2]

§ **1501. Comments on the Mechanics' Bank Case.**—The Court of Appeals of New York in the celebrated case alluded to in the preceding paragraph, involving an overissue of certificates of shares in a railway corporation, historically known as the "Schulyer frauds," in an opinion on this question by Comstock, J., stated their conclusions as follows: "1. The certificate was void in the hands of Kyle, the first holder, because it was fraudulently issued and he paid nothing for it. 2. It was also void in his hands, because issued by an agent without authority, there being no surrender of a previous certificate, and no transfer to him on the books of actual stock, and this want of authority was known to him. 3. It was void because the stock it professed to represent had no existence, and could not exist under the charter of the company, all the powers of the corporation in the creation and issue of stock being exhausted. In respect to the conclusion last mentioned, it must be, and I think is conceded, as a further result, that the certificate is void under all possible circumstances, so that no person, in whatever situation, can claim under it the rights of a stockholder, or damages, on the ground of a refusal to admit him to such rights. As the law will not require the defendant to violate its charter by creating an excess of stock to supply this spurious certificate, so it will not punish it in damages for refusing simply to be guilty of such violation? I consider this result so necessary, and so evident as not to require further discussion."[3]

[1] New York &c. R. Co. *v.* Schuyler, 34 N. Y. 30,—which case must be regarded as overruling in large part at least, the case of Mechanics' Bank *v.* New York &c. R. Co., 13 N. Y. 599; American Wire-Nail Co. *v.* Bayless, 91 Ky. 94; *s. c.* 12 Ky. L. Rep. 694; 15 S. W. Rep. 10.

[2] See *post*, § 1504.

[3] Mech. Bank *v.* New York &c. R. Co., 13 N. Y. 599, 620.

This case is one of many cases relating to the law of corporations which illustrates the naked injustice involved in the conclusions of courts which have attempted to proceed in determining the liabilities of these artificial bodies upon technical lines of reasoning. In the particular case the corporation had appointed Schuyler its agent to issue new certificates of shares of its capital stock, upon the surrender by transferees of old certificates. It had, therefore, clothed him with the power to send out to the public and to place upon the markets of the world, certificates of its shares of capital stock entirely genuine so far as the public could have any means of discovering, without suspecting fraud where all seemed fair and honest, and going into an investigation of the actual amount of shares of the stock of the company which had been issued, — a thing so entirely impracticable that the public could not be expected to stand under the burden of so doing. Having thus placed in his hands the power, acting in its name with the full semblance of authority, and doing acts having precisely the same appearance, so far as the public could see or know, as the acts which it authorized him to do, — the decision enables it to repudiate such of his acts as are fraudulent, while taking to itself the advantage of such of them as are genuine, and of casting upon the innocent public the obligation of standing as a guarantor of the frauds of its own agent. Under the rule laid down by this decision, the public have absolutely no means of protection against frauds of this kind; but if they deal in shares of corporations at all, they assume the risk of the honesty of the agent of the corporation by whom they are issued, without having the power to appoint the agent and without having any superintendence over his conduct. A decision so monstrously unjust could only be reached as the conclusion of judges who have ascended the bench after a life-time of professional activity in a calling where the habit of defending injustice as well as upholding justice has rendered their consciences callous and indifferent to the moral results of their actions.

The decision is not only thus baldly and palpably unjust, but it is contrary to both principle and to the best modern authority. It reaches the wild length of holding that, whenever the agent of a corporation, acting within the apparent scope of his authority, commits a wrong upon innocent third persons dealing with the corporation or in its securities, the corporation is not answerable unless the doing of the act in which the wrong was involved was itself within the charter power of the corporation. Such a conclusion proves too much, because it proves that no corporation has the power to commit any tort whatever, since no corporation is clothed by the government, in its charter, governing statute, or other constating instrument, with any such power. If the committing of a fraud of this kind is *ultra vires*, upon parallel lines of reasoning

the committing of an assault and battery or the publishing of a libel must be held to be *ultra vires*, because the corporation is clothed with no power to do any of these acts, and therefore a multitude of decisions which hold that corporations may be responsible for torts *simpliciter* are overthrown.[1]

The decision is contrary to the policy which should govern the decision of questions of this kind in a commercial community. The question itself is one of extreme simplicity. A body of men join together and organize a corporation. These men create an agent to do certain things. It is their duty to put an honest man in that position of trust and to superintend him and watch him. The public have no part in appointing him, nor can they superintend him or watch him. Acting within the apparent scope of this agency, doing to all appearances precisely what they have authorized him to do, he defrauds the innocent public and gets the money of innocent strangers. Upon every principle of sound commercial policy, because sound commercial policy is founded upon enlarged views of right and justice, these shareholders, and not the innocent public, ought to be answerable for the frauds of their agent. Again, shares of corporate stock have become the subject of constant transfer, as much so as negotiable bonds, and therefore considerations of commercial safety and convenience would dictate that in case of a fraudulent overissue, the maxim should apply, as against the corporation by whose agent the fraud was committed, that where one of two innocent persons must suffer for the wrong of a third person, the loss shall rather fall upon the party who clothed such third person with the power to commit the wrong

The sound view upon a question of this kind would seem to be that which holds a corporation, like any other principal, liable for the consequences of a misrepresentation made by its agent who is by it *empowered to make representations* upon a given subject. There is both reason and authority for holding that, if a corporation appoints an agent and clothes him with the power of doing certain things or transacting certain business which requires him to make certain representations, and in the apparent exercise of this power, he makes misrepresentations, the corporation will be liable for damages to the person injured.[2] Now a fraudulent and *ultra vires* issue of certificates of corporate stock, by an agent of the corporation who is authorized generally to issue certificates of this stock, goes before the public as a representation by an authorized agent of the corporation that the certificate is genuine. Upon what principle can the corporation appoint this agent to make such representations to the public, and then escape liability to an inno-

[1] *Post*, Ch. 137. *et seq.*

[2] *Post*, Ch. 139.

cent member of the public for his representations so made when they are false? But it seems scarcely necessary to pursue this celebrated decision further, for it seems to have been overthrown, in most of its conclusions, not only in New York, but in most other American jurisdictions, as elsewhere shown in this article.[1]

§ 1502. Purchaser not Innocent where Circumstances put Him on Inquiry. — On general principles, one who neglects the obvious means of knowledge, and neglects to follow up circumstances which are sufficient to put an ordinarily careful and prudent man on inquiry, will not stand in the category of innocent purchasers, within the meaning of the principle here invoked.[2] When, therefore, it appeared that, at the time of the purchase of the certificate by plaintiffs, it was well known that the principal defendants were the managers and directors, and had been such managers and directors since the corporation's

[1] The doctrine that the corporation will be liable for the damages sustained by one who has been injured by a fraudulent overissue of certificates of shares of its corporate stock, made by its agent having power to issue such certificates, on the principle of his having sustained a loss in consequence of the misrepresentation of the agent of the corporation, as embodied in the fraudulent certificate so issued by him, is denied in the case upon which these comments are made, in the following reasoning by Comstock, J.: "All that can be said in behalf of the plaintiffs is, that the certificate itself implied a representation or assurance that it was issued within the power; in other words, that the conditions on which the power depended had been fulfilled. Even this representation, when closely scanned, was no more than an inference of the dealer that, as the agent had no authority to certify except under conditions, those had been in fact performed. But the conclusive answer is, that the defendant never authorized any such representations. To say that it had, would be simply saying that it authorized the certificate, because the representation was contained in that, and existed nowhere else; and this would be assuming the very point in dispute. The representation or assurance, therefore, if such we call it, was the unauthorized act of the agent. Upon this the plaintiffs naturally no doubt relied; and so doubtless the dealer did upon the bill of lading in Grant *v.* Norway, 10 Com. Bench, 665, which contained an express declaration that the goods were shipped. The precise difficulty is that they relied upon the appearance which the agent gave to the act, and by that they were deceived. They were under no deception as to the power in its real or apparent scope. Testing the question by any rule of agency with which I am acquainted, the defendant was not bound by the transaction." Mech. Bk. *v.* N. Y. &c. R. Co., 13 N. Y. 599, 636.

[2] *Ante*, § 1371 *et seq.* This, without any controversy, is the doctrine as to who is, and who is not, an innocent purchaser. *Post*, § 1680, *et seq.*

organization, and that the plaintiffs purchased with knowledge of such facts, and of the further fact that under the law none but stockholders could be directors of a corporation, and that the certificate which they purchased was not under the seal of the company, and was not signed by its president, was a statement by the secretary that the person named therein would be entitled to a certain number of shares *when issued*, — it was held that the plaintiffs were put upon inquiry; that a reasonable inquiry would have disclosed the condition of affairs as shown by the books of the corporation; and that, under this aspect of the case, plaintiffs were not entitled to a decree of cancellation.[1]

§ 1503. May have an Action against the Officer Guilty of the Fraud.— If, after all the stock which the corporation is entitled to issue has been issued and taken by the public, the directors fraudulently issue further shares and put them upon the market as shares lawfully issued, and they are purchased by any one on the faith that they are lawfully issued, he may, in an action at law against the directors guilty of the fraud, recover the damages he has thus sustained.[2] If in such an action the plaintiff show that the certificates of the stock which he purchased were issued after all the stock which the company had the lawful right to issue had been taken, and there was no evidence that any stock had been surrendered, he has made out a *prima facie* case against the directors.[3] The burden is then cast upon the defendants to show that the plaintiff's certificates were issued upon the surrender or upon the transfer of genuine stock; and they do not do this by merely showing that, prior to the time when the plaintiff purchased his stock, there were frequent surrenders or reissues of stock; because it might well be that all such surrenders and reissues were surrenders and reissues of the bogus stock.[4] Upon principles elsewhere discussed, it is not neces-

[1] Byers *v.* Rollins, 13 Colo. 22; *s. c.* 21 Pac. Rep. 894.

[2] Bruff *v.* Mali, 36 N.Y. 200; Shotwell *v.* Mali, 38 Barb. (N. Y.) 445; Cazeaux *v.* Mali, 25 Barb. (N. Y.) 578. That directors of a corporation, who put on the market false securities in the name of the corporation, are individually liable, in an action of deceit, to purchasers of such securities who are thereby injured, see Clark *v.* Edgar, 12 Mo. App. 345; *s. c.* 84 Mo. 106; Shotwell *v.* Mali, 38 Barb. (N. Y.) 445.

[3] Bruff *v.* Mali, *supra*.

[4] *Ibid.*

sary, in order to sustain such an action, that the purchaser of such stock should have purchased it from the company or from the defendants; he may maintain the action although he purchased it in the market from other persons.[1]

§ **1504. The Same Subject.** — In accordance with this principle it has been held that one who has sustained damage in consequence of having purchased shares of the stock of a company which had been fraudulently issued by its directors after all the authorized stock had been subscribed for, might maintain an action against the directors for the injury, although he did not buy the stock of the company or of the defendants. The false certificates were sent forth by the defendants and thrown on the market by them, in the view of established and well known commercial usages. "They authenticated them — falsely and fraudulently attested them as genuine. They bore on their face such false attestation, which was equivalent to an assertion on their part to all persons who should purchase or to whom they should be offered, that they were genuine. In this way they invited confidence and induced trade. These acts were done with intent to defraud any and all purchasers, well knowing that every person to whose hands these false certificates should come by fair purchase might be injured. Therefore, having authenticated and issued these certificates for the purpose of defrauding, the defendants should be held liable to any one sustaining damage by purchasing on the faith of their genuineness. In this view the defendants are to be considered as acting directly upon and influencing the purchaser; and, of course, liable, as every tort-feasor is, for the damages occasioned by their wrongful act."[2] In a recent English case the plaintiff contracted to make a railway, and did work for which, the company being unable to pay cash, a contract was made whereby plaintiff agreed to accept debenture stock in lieu thereof. The defendants, who were

[1] *Ibid.* But see Peek *v.* Gurney, L. R. 6 H. L. 377. *Evidence* insufficient to sustain the charge of a fraudulent overissue: Smock *v.* Henderson, 1 Wilson (Ind.), 241.

[2] Bruff *v.* Mali, 36 N. Y. 200, 204; *ante*, § 1500. To the same effect is Shotwell *v.* Mali, 38 Barb. (N. Y.) 445 (overruling Seizer *v.* Mali, 32 Barb. (N. Y.) 76, which was subsequently reversed, and the judgment of the special term affirmed; 41 N. Y, 619); Cazeaux *v.* Mali, 25 Barb. (N. Y.) 578.

directors of the company, thereupon issued to the plaintiff certificates, signed by two of the defendants, for the agreed amount of debenture stock. At that time, although unknown to the defendants, all the debenture stock which the company was entitled to issue had been issued, and consequently what plaintiff had received was an over-issue and valueless. The company went into liquidation, but its valid debenture stock retained its par value. It was held, in an action to make the defendants personally liable for the amount of debenture stock which should have been issued to the plaintiff under the agreement, that the defendants were liable on their implied representation that they had authority to issue valid stock which would be a good security; and that, under the circumstances, the damages were the nominal amount of stock that the plaintiff should have received under the agreement.[1]

§ 1505. Plaintiff must have Acted on the Faith of the Representations. — But the plaintiff cannot in any case recover, where his proof falls short of showing that he was in fact deceived by the representations made.[2] This is a general rule in the law of fraud.[3] Where it appears that the plaintiff at the time of purchasing the stock had true information of the matters concerning which the fraudulent representations were made by the directors, he can not sustain the action; for in such a case it does not appear that he was misled by their fraud.[4]

§ 1506. Remedy of the Corporation against Its Agents for the Damages thereby Sustained by It.— The corporation has remedies, both at law and in equity, to recover from its agent by whom the fraud was committed, the damages which it thereby sustained. It has been held that a corporation whose treas-

[1] Firbank *v.* Humphreys, 18 Q. B. Div. 54; *s.* *c.* 56 L. J. (Q. B.) 57; 56 L. T. (N. S.) 36; 35 Week. Rep. 92. In an action on the case for a fraudulent sale of stock, brought against the self-styled president and the secretary of a fictitious joint-stock company, — it is not necessary to show any *privity of contract* between the plaintiff and the secretary. Bauman *v.* Bowles, 51 Ill. 380.

[2] Eaglesfield *v.* Londonderry, 4 Ch. Div. 693; Priest *v.* White, 89 Mo. 609.

[3] Dunn *v.* White, 61 Mo. 186; *ante*, §§ 1384, 1476.

[4] Priest *v.* White, *supra.*

urer fraudulently issues and circulates stock which becomes so intermingled with the genuine stock as to be indistinguishable therefrom, and appropriates the proceeds to his own use, may recover the moneys from the treasurer in an action of general *assumpsit;* and the treasurer cannot defend on the ground that the certificates which he thus fraudulently issued were illegal and void.[1] Where the fraudulent certificates which the authorized agent of the corporation has put forth are binding upon the corporation, it is entitled to maintain a suit in *equity* against the agent for a *discovery* and *account* of the moneys which he has received through the negotiation of such fraudulent certificates, and for a recovery of the same. Such an action, it has been held, proceeds upon the implied contract which binds every agent to keep his principal indemnified; upon the right which every party entitled to be indemnified has for relief against the anticipated consequences of the liability after it has occurred but before it has been consummated against him, by a recovery at law or in equity; and also in view of the extent and complexity of the claim where many such fraudulent certificates have been negotiated.[2] The jurisdiction of a court of equity in such a case is, therefore, supported on the ground of the *want of an adequate remedy at law*,[3] of the right of a principal to an *accounting* by his agent,[4] upon the ground of *trust*[5] and also on the ground of *fraud*.[6]

[1] Rutland R. Co. *v.* Haven, 62 Vt. 39; 19 Atl. 769. See also East New York &c. R. Co. *v.* Elmore, 5 Hun (N. Y.), 214.

[2] Bank of Kentucky *v.* Schuylkill Bank, 1 Park. Sel. Cas. (N. Y.) 180, 216-218. The court proceed upon the doctrine laid down in Renelaugh *v.* Hayes, 1 Vern. 189, to the effect that equity will give relief to a covenantee against his covenantor in the case of an express covenant of indemnity even before the covenantee has been compelled to pay the money against which he is by the covenant indemnified, especially when the taking of long and intricate accounts is involved. See also Flight *v.* Cook, 2 Ves. Sr. 619; Baker *v.* Shelbury, 1 Cas. in Chan. 70.

[3] See upon the general doctrine that equity relieves upon this ground, Boyce *v.* Grundy, 3 Pet. (U. S.) 215; New London Bank *v.* Lee, 1 Conn. 112; *s. c.* 27 Am. Dec. 713; American Ins. Co. *v.* Fisk, 1 Paige (N. Y.), 90; Wamburzee *v.* Kennedy, 4 Desau. 481; Weymouth *v.* Boyer, 1 Ves. 416.

[4] For this doctrine see McKenzie *v.* Johnson, 4 Madd. 198; Massey *v.* Banner, *Id.* 416; and compare King *v.* Rossett, 2 You. & J. 33.

[5] Hovenden on Frauds, Sec. 162.

[6] Burrowes *v.* Lock, 10 Ves. 470; Green *v.* Barrett, 1 Sim. 45; Blain *v.* Agar, 1 Sim. 37; Colt *v.* Woollaston, 2 P. Wms. 154.

CHAPTER XXV.

THE SURRENDER OF SHARES AND RELEASE OF SHAREHOLDERS.

§ 1511. Subscriber Cannot Withdraw at Pleasure. — It takes two parties to make a contract; and when a contract is fairly and legally made, it takes the consent of two parties to rescind it. Neither party can withdraw from it at pleasure and without the consent of the other. It is the mere application of this legal truism to say that one who has entered into a valid contract of subscription to the shares of the capital stock of a corporation cannot withdraw therefrom at pleasure.[1] A subscriber cannot, as against the corporation, withdraw his subscription at pleasure, even if we lay out of view the rights of other subscribers or those of creditors.[2] He cannot rescind his subscription by releasing to the corporation what he has paid thereon; for the right of forfeiture belongs not to subscribers, but to the corporation, and the corporation may *waive* its statutory right to forfeit the shares and resort to its common law remedy by action on the contract of subscription.[3] If a corporation has been regularly organized, creditors having dealt with it may enforce payment of subscriptions, although the subscribers may have notified the company that they would not be liable for debts,

[1] United Society *v.* Eagle Bank, 7 Conn. 456; Modern Life Ins. Co. *v.* Keller, 3 Pa. County Ct., 118; Cheraw &c. R. Co. *v.* White, 10 S. C. 155; Ryder *v.* Alton &c. R. Co., 13 Ill. 516; Ollesheimer *v.* Thompson Man. Co., 44 Mo. App. 172; Bordentown Turnpike Co. *v.* Imlay, 4 N. J. L. 285; Johnson *v.* Wabash &c. Plank Road Co., 16 Ind. 390; Selma &c. R. Co. *v.* Tipton, 5 Ala. 787; *s. c.* 39 Am. Dec. 344, 357. American decisions on right of subscriber to stock of corporation to withdraw his subscriptions are collected in 21 Am & Eng. Cas. Corp. 333, n.

[2] Ryder *v.* Alton &c. R. Co., 13 Ill. 516.

[3] Klein *v.* Alton &c. R. Co., 13 Ill. 514; *post,* § 1784.

upon the assumption that the corporate existence was without authority of law.[1] But, if the corporation has not been organized according to the mutual contract of the co-adventurers, a dissenting subscriber, who is not affected by any circumstance of estoppel, and who has not been guilty of *laches*, may, it seems, withdraw, even as against creditors.[2] But this principle seems to apply only where the scheme to which he subscribed has been departed from or abandoned. Thus it has been held in England that one who with others has subscribed to a scheme of incorporation for which an act of Parliament is to be procured, cannot, while the bill is pending before Parliament, withdraw from the scheme so as to escape liability, by renouncing before the committee of Parliament all connection with it and desiring that his name might be omitted from the act. Nor could the circumstance of his name being omitted from the act have the effect of disengaging him.[3] And where shares of stock are issued to a person and receipted for by him in the usual form, and the transaction is regularly entered upon the books of the corporation, he cannot, by writing across the face of the certificates the word "cancelled" and by returning them to the secretary of the company, make himself any the less a shareholder in respect of his liability to creditors of the corporation; though it is conceded that "this doctrine does not extend so far as to annul a *bona fide* compromise of a question fairly in dispute, made between a corporation and one whom it claims to hold liable as a stockholder, nor a compromise which becomes necessary to save the company from hopeless embarrassment."[4] "Nothing," said the court, "could be more futile. The relation between a shareholder and a corporation is one of contract. It cannot be dissolved by one party without the consent of the other, unless in pursuance of a special reservation in the charter, or in the terms of the subscription. It does not appear that the corporation ever consented to the proposed surrender. Indeed, it had no authority to do so with any legal effect as against creditors. There is such a thing as an authorized forfeiture, in the option of the company, for non-pay-

[1] Gaff *v.* Flesher, 33 Ohio St. 107.

[2] *Post*, §§ 1528, 1542; *ante*, §§ 71 *et seq.*, and §§ 1262, 1270.

[3] Kidwelly Canal Co. *v.* Raby, 2 Price, 93. See also Martyn *v.* Hynd, 1 Doug. 142; *s. c.* Cowp. 437; Religious Soc. *v.* Stone, 7 Johns. (N. Y.) 112.

[4] *Post*, § 1553.

ment of assessments. But even this is not allowed if the corporation be insolvent, and the forfeiture, by releasing the stockholder from further liability, will be prejudicial to creditors. Nor can a corporation, in any case, voluntarily release a stockholder so as to discharge him from his contingent liability for the company's debts."[1]

§ **1512. Nor can Corporation Release Him.** — Nor can a corporation, by a mere agreement with a stockholder, otherwise than by a valid forfeiture of his shares under the terms of the charter or by-laws, or a *bona fide* compromise hereafter spoken of,[2] release him from his obligations to the corporation.[3] We have already seen[4] that the issuing of a *certificate* to a subscriber is not at all necessary to make him a shareholder. By parity of reasoning, the mere act of surrendering the certificate does not divest the shareholder of his liabilities as such, at least as against creditors. In a case where this has been attempted, and where the rights of creditors were involved, it was said: "In every possible aspect of the matter, the *cancellation of the certificates* amounted to nothing. The certificates were not the stock. They were merely documentary evidence of its existence. All the duties, privileges and responsibilities of a stockholder may be fully vested in him where no certificate has ever been issued."[5]

§ **1513. Invalidity of Extrinsic and Collateral Agreements Releasing Shareholders.** — In conformity with the principle stated in the preceding section, the courts have held with the greatest unanimity that, where the contract of subscription is absolute on its face, no extrinsic or collateral agreements between the subscriber and the promoters or agents of the corporation who procure him to subscribe, not amounting to fraudulent representations on their part, can be shown in evidence for the

[1] Chouteau *v.* Dean, 7 Mo. App. 210, 216; opinion by Lewis, P. J.

[2] *Post*, § 1553.

[3] Melvin *v.* Lamar Ins. Co., 80 Ill. 459; *s. c.* 22 Am. Rep. 199. Compare Carr *v.* LeFevre, 27 Pa. St. 413.

[4] *Ante*, § 1140.

[5] Chouteau *v.* Dean, 7 Mo. App. 210, 216.

purpose of discharging or reducing his liability as a stockholder whether to the corporation or to its creditors.[1]

§ 1514. Such a Release not Good as between the Corporation and the Subscriber. — The general doctrine is that the corporation has *no legal capacity* to release an original subscriber to its capital stock from the obligation of paying for his shares, in whole or in part, and that any arrangement with him by which the company, its creditors, or stockholders, shall lose any part of that subscription is *ultra vires* and a fraud upon the creditors and the co-subscribers.[2] As we shall see in this and the following chapter, the American courts, with great unanimity, hold to the clear and strong expression of doctrine by Mr. Justice Strong in a leading case: "It is clear that the directors of a company, organized under the law, have no power to destroy it, to give away its funds, or deprive it of any means which it possesses to accomplish the purposes for which it was incorporated. The stock subscribed is the capital of the company, its means for performing its duty to the commonwealth, and to those who deal with it. Accordingly, it has been settled by very numerous decisions that the directors of a com-

[1] Mangles *v.* Collier, Grand Dock Co., 10 Sim. 519; Chouteau *v.* Dean, 7 Mo. App. 210; Haskell *v.* Sells, 14 Mo. App. 92; Pickering *v.* Templeton, 2 Mo. App. 425; Thompson *v.* Reno Savings Bank, 19 Nev. 103; *s. c.* 3 Am. St. Rep. 797; White Mountains R. Co. *v.* Eastman, 34 N. H. 124, 140; Cunningham *v.* Edgefield, &c. R. Co., 2 Head (Tenn.), 23; Connecticut &c. R. Co. *v.* Bailey, 24 Vt. 465; *s. c.* 58 Am. Dec. 181; North Carolina R. Co. *v.* Leach, 4 Jones L. (N. C.) 340; Mississippi &c. R. Co. *v.* Cross, 20 Ark. 443; Evansville &c. R. Co. *v.* Posey, 12 Ind. 363; Smith *v.* Tallehassee &c. R. Co., 30 Ala. 650; Kennebec &c. R. Co. *v.* Waters, 34 Me. 369; Minneapolis Threshing Machine Co. *v.* Davis, 40 Minn. 110; *s. c.* 12 Am. St. Rep. 701; Baile *v.* Calvert &c. Education Soc., 47 Md. 117; Robinson *v.* Pittsburgh &c. R. Co., 32 Pa. St. 334; *s. c.* 72 Am. Dec. 792; Greenville &c. R. Co. *v.* Coleman, 5 Rich. L. (S. C.) 118; Thigpen *v.* Mississippi Central R. Co., 32 Miss. 347; Marshall Foundry Co. *v.* Killian, 99 N. C. 501; *s. c.* 6 Am. St. Rep. 539; Morrow *v.* Nashville &c. R. Co., 87 Tenn. 262; *s. c.* 10 Am. St. Rep. 658; Scovill *v.* Thayer, 105 U. S. 143; Union Mutual Life Ins. Co. *v.* Frear Stone Man. Co., 97 Ill. 537; *s. c.* 37 Am. Rep. 129; Jewell *v.* Rock River Paper Co., 101 Ill. 57; Olleshiemer *v.* Thompson Man. Co., 44 Mo. App. 172, 182.

[2] So stated in substance by Mr. Justice Lamar in Morgan *v.* Struthers, 131 U. S. 246, 254. So held in Burke *v.* Smith, 16 Wall. (U. S.) 390, 395; Bedford R. Co. *v.* Bowser, 48 Pa. St. 29.

pany are incompetent to release an original subscriber to its capital stock, or to make any arrangement with him by which the company, its creditors, or the State shall lose any of the benefit of his subscription. Every such arrangement is regarded in equity, not merely as *ultra vires*, but as a fraud upon the other stockholders, upon the public, and upon the creditors of the company. It is upon these principles that the appellants in this case rely, and the question is whether they are applicable to the facts as found." [1] This doctrine, illustrated, as we shall see by a great number and variety of cases, must have one (or both) of two meanings: 1. That such an arrangement is *ultra vires* in a primary sense, — that is that it is against public policy, and is hence invalid although sanctioned by all the stockholders. 2. That it is *ultra vires* in a secondary sense, — that is, *ultra vires* the directors, and hence not good as against the corporation except by the unanimous consent of the stockholders. The meaning of either of these propositions is that it is not good as against the corporation. Statutes and constitutional ordinances exist, which in terms or by implication carry with them the same prohibition. Thus, in Missouri, the statute having provided the mode by which a corporation may *reduce its capital stock*, it has been reasoned that it can reduce it in no other way; and consequently that business corporations cannot exchange their goods for their capital stock so as to reduce or retire the latter; and the corporation may deny the legality of such a contract where it has not received the benefit of the consideration, and where to do so would not work a fraud on the opposite party.[2] So the Revised Statutes of New York contain a prohibition of the withdrawal of their capital by corporations; but this has been justly held not to prevent a return by the corporation to the original subscribers of the tangible assets of the corporation conveyed by the subscribers to it, and which formed the basis of its original capitalization, where they pay to the company the sum at which such assets were capitalized.[3] It is to be regretted that the doctrine has acquired even

[1] Burke *v.* Smith, 16 Wall. (U. S.) 390, 395.

[2] St. Louis Carriage Manuf. Co. *v.* Hilbert, 24 Mo. App. 338, 343. See also Coppin *v.* Greenless, 38 Ohio St. 275.

[3] Skinner *v.* Smith, 56 Hun (N. Y.), 437; *s. c.* 31 N. Y. St. Rep. 448. It is

a limited foothold that agreements by which corporations release their subscribers are not *ultra vires* but valid as between the parties to such agreements.[1] Whatever room there may be in legal reason for the view that such an agreement is good as between the immediate parties to it, there is certainly no sound conception on which the conclusion that it is good as against the assignee of the corporation, appointed in consequence of its insolvency, can be upheld.[2] Nor is the view that such an agreement is good until it is set aside in a direct proceeding for that purpose, a sound one. By all the holdings which declare such agreements invalid, the shareholder is treated precisely as though the agreement had not been made, and is held, both in law and in equity, to the liability assumed by his contract of subscription notwithstanding the void attempt to release it.[3]

§ 1515. But Personal Agreements by Promoters, Directors, or other Shareholders to Repurchase are Valid. — But as every

to be inferred from the report that they gave their note, or notes for the sums which were afterwards paid.

[1] In Illinois the surrender by stockholders of a corporation of their share certificates upon which 20 per cent. has been paid, and the issuance to them of certificates for paid-up stocks for one-fifth of the amount relinquished is held to be in legal effect, a purchase by the company of the unpaid stock at its par value, and the transaction, if in good faith, is not *ultra vires* as between the parties. Republic L. Ins. Co. *v.* Swigert, 135 Ill. 150; *s. c.* 9 Rail. & Corp. L. J. 22; 25 N. E. Rep. 680.

[2] The Supreme Court of Alabama has lately held that a resolution adopted by a corporation authorizing the subscribers to the capital stock to reduce their subscriptions by the surrender of unpaid shares, being valid as between the company and the subscribers, the assignee of the company cannot maintain an action to recover the face value of shares surrendered until the surrender has been set aside in a proceeding brought for that purpose. Glenn *v.* Hatchett, 91 Ala. 316; *s. c.* 8 So. Rep. 656.

[3] There is a decision in Maryland which seemingly recognizes the principle that such an agreement is good as between the parties. The by-laws of a *joint stock corporation* with somewhat peculiar articles provided that a member might withdraw on giving a certain notice, the refunding not to exceed one-eighth of the capital paid in. It was held that after such notice etc., the person no longer occupied the position of a member of the corporation, except for the purpose of receiving his money, but the relation of debtor and creditor supervened between him and the corporation. As such creditor, he would be entitled to demand the money advanced on his share to the company, not a dividend upon the funds of the corporation. Gaehle's Piano Manuf. Co. *v.* Berg, 45 Md. 113.

shareholder, in the absence of fraud, or of conventional or statutory restraints, has the right freely to sell and transfer his shares in like manner as the owner of any other property may sell and transfer it, — the principle above stated is not infringed by an agreement between the promoters of a company and one whom they procure to become a subscriber to its shares, by which the subscriber retains the option to sell the shares to the promoters and thus withdraw from the enterprise. Whatever may be the effect of such an agreement between the subscriber and the corporation, it is good as between him and the promoters, and he may enforce its obligation against them in an appropriate action.[1] Such an agreement, it is reasoned, is not avoided by the principle which avoids secret preferences in composition agreements.[2] This is quite in accordance with many English holdings, which Sir Nathaniel Lindley thus states, citing the cases in the margin: [3] "It is further necessary to distinguish the retirement of a shareholder by relinquishing his shares to the company, from his retirement by transferring his shares to some or one of the directors of the company upon their own individual account. For whilst, in the absence of special authority, it is not competent for directors to accept on behalf of a company the surrender of shares held in the company, it is as competent for the directors of a company, as for anybody else, to accept shares in the company from such shareholders as may be willing to transfer them in the ordinary way. Consequently, an agreement between the directors and some of the shareholders of a company to the effect that the latter shall relinquish their shares and transfer them to the directors, is not *ultra vires*, or in any way illegal, if the agreement is with the directors as individuals, and not with them as representing the company.[4] Upon the same principle, if a shareholder transfers his shares to a director or to an ordinary individual, without notice that the director is

[1] Morgan *v.* Struthers, 131 U. S. 246; Meyer *v.* Blair, 109 N. Y. 600, 607; *s. c.* 4 Am. St. Rep. 500.

[2] As to which see White *v.* Kunz, 107 N. Y. 518; *s. c.* 1 Am. St. Rep. 886, which both of the preceding cases distinguish. Compare Bank of Commerce *v.* Hoeber, 11 Mo. App. 475, 479.

[3] Lind. Comp., 5th ed., p. 521-2.

[4] Haddon *v.* Ayers, 1 E. & E. 118. See too Jessopp's Case, 2 De G. & J. 638. In Cartnell's Case, 9 Ch. 691, the directors never assented to the transfer made to them.

acting on behalf of the company, the transfer or does effectually retire from the company; although had he known that he was in fact surrendering his shares to the company, the surrender would have been invalid.[1] Moreover, directors who individually agree to accept a surrender of shares and to indemnify the surrenderor against calls, are personally bound by their agreement, whether it is, as regards the company, *ultra vires* or not." [2]

§ 1516. **No Right of Withdrawal as against Existing Subscribers.** — A withdrawal by one subscriber infringes the rights of all the others, because the contract of subscription is, at least in the sense which creates an estoppel, a contract among the several co-subscribers. It is a multi-partite contract, so to speak, a contract of the several subscribers with each other. No one of the subscribers can, therefore, withdraw from the contract without the consent of all the others, and thereby diminish without the universal consent, the common fund in which all have acquired an interest.[3] This is in accordance with the English doctrine as thus stated by Sir Nathaniel Lindley:[4] "The right of a shareholder to retire by surrendering his shares, is not one of those matters as to which a majority of members binds a minority, or as to which directors have any implied authority to represent the company. Both principle and authority are clearly opposed to any such doctrine." [5] Some of the courts, as already seen, allow this principle to operate only from the time when the act of incorporation is obtained, or the corporation has been otherwise lawfully called into existence;[6] but these courts agree that, after that time no subscriber can withdraw without the consent of the others, whether the work of the corporation has

[1] See Holwey's Case, 1 De G. & S. 777; Ex parte Bagge, 13 Beav. 162; Nichols' Case, 3 De G. & J. 387.

[2] Barker *v.* Allan, 5 H. & N. 61.

[3] Johnson *v.* Wabash &c. R. Co., 16 Ind. 389; White Mountains R. Co. *v.* Eastman, 34 N. H. 124; Graff *v.* Pittsburg &c. R. Co., 31 Pa. St. 489; Miller *v.* Hanover Junction &c. R. Co., 87 Pa. St. 95; *s. c.* 30 Am. Rep. 349; Melvin *v.* Lamar Ins. Co., 80 Ill. 446; *s. c.* 22 Am. Rep. 199; conceded in Morgan *v.* Struthers, 131 U. S. 246, and in Meyer *v.* Blair, 109 N. Y. 600; *s. c.* 4 Am. St. Rep. 500.

[4] Lind. Comp., 5th ed., p. 517.

[5] Distinguishing Plate Glass &c. Co. *v.* Sunley, 8 El. & Bl. 47.

[6] *Ante*, § 1162 *et seq.* Muncy Traction Engine Co. *v.* De La Green, 21 Am. & Eng. Corp. Cas. 328; *s. c.* 13 Atl. Rep. 747.

been entered upon or not.[1] But the better opinion is that there is no *locus pœnitentiæ* open to him between the time of subscribing and the actual creation of the company, for reasons which we have already discussed; but that after he has subscribed, and others have subscribed, he cannot retire and leave them in the lurch. Thus, it has been held that one who signs the provisional subscription paper is liable as a stockholder to creditors after the insolvency of the corporation, although he had an understanding with the promoters that he should have an option to withdraw until the expiration of sixty days, and although he exercised the option, and his name did not in fact go into the articles of association.[2] Again, although, in general, a written obligation is not binding until it is *delivered*,[3] yet one who signs his name to a subscription paper and procures others to sign also, cannot erase his name therefrom so as to release him, even before the paper has been delivered to the corporation.[4] The well-known element of equitable estoppel enters into such cases: a release of the subscriber will not be allowed, because it would work a *fraud* on the other subscribers. Accordingly it has been held that a ratification of a fraudulent sale of stock to a corporation by stockholders owning a majority of stock, made at a meeting of stockholders controlled by their votes, is not binding upon stockholders who did not consent to the purchase.[5]

§ **1517. Nor as Against Creditors.** — For even stronger reasons there is no right of withdrawal as against creditors of the corporation. Repeating the well-known proposition under this head, that the capital stock of the corporation is a trust fund for its creditors,[6] its custodians can never give it away nor embezzle it without the consent of the beneficiaries. Capital which has been subscribed but not paid in, is a part of this fund, as much as capital which has been paid in.[7] The custodian, that is to

[1] Twin Creek &c. Turnpike Road Co., *v.* Lancaster, 79 Ky. 552.

[2] Haskell *v.* Sells, 14 Mo. App. 92.

[3] *Ante*, § 1253.

[4] Cheraw &c. R. Co. *v.* White, 10 S. C. 155.

[5] Woodroof *v.* Howes, 88 Cal. 184; 9 Rail & Corp. L. J. 352; 26 Pac. Rep. 111.

[6] *Post*, § 1569, *et seq.*

[7] Shickle *v.* Watts, 94 Mo. 410; Heggie *v.* Building & Loan Asso., 107 N. C. 581; *s. c.* 12 S. E. Rep. 275. Hence a release by an insolvent cor-

say, the stockholder who still holds it, cannot be permitted to convert it to his own use, nor can the directors, its guardians, be permitted to release it or give it away, as against the beneficiaries in the trust. It is the duty of the stockholder to pay it, and of the directors to enforce the payment of it, for the benefit of the creditors.[1] Nor can the entire corporate body composed of the shareholders at large, acting in their constituent character, release or give away this trust fund. And, therefore, a corporate by-law or resolution which undertakes to release the obligation of a solvent subscriber, even upon surrender of his certificate, is void as against creditors.[2] The *note* given by such a subscriber in payment of his shares is impressed with this trust character, and cannot be released in this way.[3] And though the subscription, by its terms, is payable in property, and the subscriber has, by agreement with the corporation, surrendered all claim for his shares, and they have released all claim on the property, he is still liable to creditors.[4] Whether the subscriber cannot, with the consent of the directors, substitute another subscriber in his place, except by transfer in the regular mode, is equally doubtful. That he cannot do it without the sanction of the directors has been held.[5] That it cannot be done even with

poration, of an unpaid portion of a subscription to its capital stock is fraudulent and void as to its creditors, although the debts were incurred before the subscription was made. Carter *v.* Union Print. Co., 54 Ark. 576; *s. c.* 16 S. W. Rep. 579; 10 Rail. & Corp. L. J. 330.

[1] *Post*, § 1521. Modern Life Ins. &c. Co. *v.* Keller, 3 Pa. County Ct. 118. That a release by the directors is of no avail to the subscriber, but leaves him liable to the creditors of the corporation, see Chouteau Ins. Co. *v.* Floyd, 74 Mo. 286, 291; Gill *v.* Balis, 72 Mo. 424, 432; Upton *v.* Tribilcock, 91 U. S. 45.

[2] Farnsworth *v.* Robbins, 36 Minn. 369; *s. c.* 31 N. W. Rep. 349.

[3] *Ibid.*

[4] Singer *v.* Given, 61 Iowa, 93. Compare an earlier case where the same court went so far as to hold, in a case not directly involving the rights of creditors, that it is competent for a corporation, if acting in good faith, to release a shareholder from the obligation of his subscription; and that, if the shareholder is afterwards sued on his contract of subscription, he can plead such release without showing specially the consent of other shareholders, or of creditors. This case proceeds upon two ideas: first, that as to the stockholders, they are, as members of the company, concluded by its acts; second, that it will be time enough to look out for the rights of the creditors when the court is judicially advised by the pleadings that their rights are in danger. Gelpcke *v.* Blake, 19 Iowa, 263, 267.

[5] Graff *v.* Pittsburgh &c. R. Co., 31 Pa. St. 489.

the assent of the directors, has lately been held, on the ground that the contract is obligatory by way of estoppel among the several subscribers.[1] The subscriber thus sought to be released may be, for instance, not only solvent, but also a man of energy and business capacity, whose business qualities and reputation would add strength to the corporation. Can *he* be allowed, as against others who perhaps have signed the subscription paper or the articles of association on the faith of his being interested in the enterprise, to retire from it and from them, and to introduce an indifferent business man in his stead, although the latter may be solvent and able to respond to assessments? And have the directors any implied power to consent to such a substitution? Thus an incorporated society which had invested some of its funds in the shares of an incorporated bank, finding that the bank was insolvent, conceived the happy thought of *withdrawing its shares* in the bank, so to speak, and of suing the bank for the amount which it had paid thereon. Of course it was held that this could not be done.[2] It also follows that, in a proceeding by a dissolved and insolvent corporation against a shareholder to recover an amount due by such shareholder to the corporation in respect of his shares, it is not competent to prove by parol evidence that, subsequently to receiving such shares, the shareholder surrendered them to the corporation for cancellation. It is said that "nothing short of a valid contract between the corporation and the defendant could avail to consummate legally the intended surrender of stock. Such a contract, if directly made by the board of directors, could not be proved otherwise than by the record of their proceedings, or by a properly authenticated instrument.[3]

§ 1518. Further of this Subject. — Following out these views, the American courts have steadily annulled all arrangements between corporations and their stockholders whereby the latter were sought to be released from their liability to creditors. Thus, it has been held that a resolution by the directors of a

[1] Ollesheimer *v.* Thompson Man. Co., 44 Mo. App. 172, 186.

[2] United Society *v.* Eagle Bank, 7 Conn. 456.

[3] Chouteau *v.* Dean, 7 Mo. App. 210.

corporation that no further calls should be made on account of stock subscribed was void, and a receiver of the corporation could proceed in equity to compel payment of what was due on account of such subscriptions to the capital stock.[1] So, a resolution passed by the directors of an insurance company releasing the stockholders from the payment of balances remaining unpaid on their stock, in accordance with which the certificates of shares were stamped "non-assessable," was held void as against policy-holders who had insured in the company without knowledge of the existence of such an agreement.[2] So, the mere fact that the word "unassessable" is printed on the certificates of shares given to a member does not impair his obligation to pay the amount due on such shares, created by the acceptance and the holding of such certificate. At most, its legal effect is said to be a stipulation against liability from further assessment or taxation after the entire one hundred *per centum* of the subscription shall have been paid.[3] Nor, under the Missouri statute of individual liability, will the delivery by a corporation to its shareholders of certificates of paid-up stock, when in fact only part of the par value has been paid, prevent a creditor of the corporation, who can show this fact, from having execution against the shareholder.[4] Nor is the liability of the stockholder, under the Mississippi statute,[5] to creditors of the corporation, discharged by a release by the corporation from further liability on his contract of subscription, his shares being still unpaid.[6] It has also been conceded that where a corporation reconveys to its stockholders lands which it has received from them in payment of their shares, a creditor, not consenting thereto may follow the property as a trust fund and subject it to the satisfaction of his debt; but it was held that where a creditor was also a shareholder and consented to the arrangement, he could not have such equitable relief.[7]

[1] Sagory *v.* Dubois, 3 Sandf. Ch. 466.

[2] Upton *v.* Hansbrough, 3 Biss. (U. S.) 417, 427.

[3] Upton *v.* Tribilcock, 91 U. S. 45.

[4] Pickering *v.* Templeton, 2 Mo. App. 424.

[5] Miss. Code, 1871, § 2413; *Id.* 1880, § 1037.

[6] Vick *v.* La Rochelle, 57 Miss. 602.

[7] Fort Madison Bank *v.* Alden, 129 U. S. 372; *s. c.* 32 L. ed. 725.

§ 1519. English Holdings on this Subject. — English holdings on this subject do not go as far as the American in upholding the rights of creditors on the theory of estoppel. They generally hold that the creditor can only recover *in right of the company*, though the question is in that country now chiefly influenced by the terms of statutes.[1] In one case in that country it is held that a resolution rescinding a contract of subscription after other subscribers have put their names on the books on the faith of it is void as to them; and that whatever may have been the reason which moved the subscriber to execute it, he remains a contributory.[2] Upon this subject Sir Nathaniel Lindley in the last edition of his Law of Companies, says, citing the authorities in the margin:[3] "The right of a shareholder to retire from a company of which he is a member, by surrendering his shares to the company, depends upon the acts of Parliament, charter, or regulations or customs which govern the company in question. Where there is nothing enabling a shareholder to retire by surrendering his shares, the ordinary partnership rule applies, and no surrender can be made except with the consent of all the shareholders.[4] If such a method of withdrawing from the company is authorized by its constitution, a surrender by a shareholder of his shares will of course be valid, if all the formalities which may be necessary are duly complied with; and where the power to surrender exists, the due observance of all necessary formalities will be presumed in favor of a shareholder who has in fact *bona fide* retired from

[1] See, for instance, Re New Eberhart Co., 43 Ch. D. 118.

[2] Holt's Case, 1 Sim. (N. S.) 389. In this case the managing director of a company had certain shares awarded to him by the provisional directors, in consideration of his services, and as he was the covenantee in the deed of settlement, and consequently unable to covenant with himself, his brother, at his request, executed the deed as the holder of the shares. Several other persons took stock after this circumstance, and executed the deed of settlement as required. Afterwards the directors rescinded the resolution by which they had awarded the shares, and the managing director delivered up the certificates for the shares to them. The vice-chancellor held that the brother had neither transferred nor forfeited the shares, as the holder of which he had executed the deed; and since by executing it he impliedly entered into obligations with all the other persons who did so to bear the common liability of the undertaking, he should be held to it upon a winding up of the company.

[3] Lind. Comp., 5th ed., p. 517.

[4] Lind. Comp., 5th ed., p. 517.

the company, and whose shares have been cancelled or otherwise been disposed of by the company."[1]

§ **1520. Further of the English Doctrine.** — That this question is treated in the English authorities rather from the stand-point of the social rights of the members of the company, than as a question of public policy, or even as one which primarily concerns the rights of creditors, is seen in the doctrine of the courts of that country that if shares have been surrendered with the knowledge of the shareholders, under circumstances fully disclosed to them all, and such surrender has not been questioned for a considerable period, *the company* will be concluded from afterwards disputing its validity.[2]

§ **1521. No Power in Directors to Accept Surrender Unless Expressly Granted.** — The English doctrine very clearly is that the directors have *no power* to accept a surrender of shares and release a shareholder unless the power is expressly granted by the governing statute, or the constating instruments of the company, or unless it has been established by its usages.[3] Moreover, if the directors of the company, not having express authority so to do, use funds of the company in buying in the shares of its members, they commit a breach of trust, and will be compelled to make good to the company the funds so expended.[4] The principle that the directors cannot take such action in the absence of express power extends to the case of persons who have agreed to take shares, but who have not actually become shareholders:

[1] See Lane's Case, 1 De G. J. & Sm. 504; Kipling *v.* Todd, and Kipling *v.* Allen, 3 C. P. Div. 350. The retirement must be complete. See Barry *v.* Navan &c. R. Co., 4 L. R. Ir. 68.

[2] Brotherhood's Case, 31 Beav. 365; *s. c.* 4 De Gex F. &. J. 566; Hunt's Case, 32 Beav. 387.

[3] Trevor *v.* Whitworth, 12 App. 409 (with which compare Dronfield Silkstone Coal Co., 17 Ch. Div. 76). See also London &c. Coal Co., 5 Ch. Div. 525; Phosphate of Lime Co. *v.* Green, L. R. 7 C. P. 43; Hodgkinson *v.* National Live Stock Ins. Co., 26 Beav. 473; *s. c.* 4 De Gex & J. 422; Burt *v.* British Nation Life Ass. Co., 4 DeGex & J. 158; Paul and Beresford's Case, 10 Jur. (N. S.) 692; Playfair *v.* Birmingham &c. R. Co., 1 Railw. Cas. 640; Walker's Case, 2 Jur. (N. S.) 1216; Harris *v.* North Devon R. Co., 20 Beav. 384.

[4] Evans *v.* Coventry, 8 De Gex M. & G. 835.

the directors have no implied power to release them from their agreement.[1]

§ **1522. Directors may not Delegate the Power.** — Even where the directors have express power to accept a surrender from a shareholder of his shares, they cannot delegate this power to a manager.[2]

§ **1523. Cases Illustrative of the English Doctrine.** — The following cases illustrative of the foregoing doctrine, are given here as they are stated in the text of Sir Nathaniel Lindley:[3] "The company's deed authorized the directors to buy up, out of certain specified funds of the company, any shares which might be offered for sale. An extraordinary general meeting resolved that if any shareholder should be desirous of withdrawing from the company, the directors should be at liberty to purchase his shares upon certain specified terms. A shareholder acted upon this resolution, complied with the terms, and sold his shares to the company. But it was held that the resolution was not binding on the company, and that the shareholder in question was properly made a contributory, although nearly five years had elapsed since his withdrawal.[4] - - - - The directors had power generally to act as might appear to them best for the interest of the company. A dispute arose among them, and one of them retired, and his shares were surrendered and cancelled. It was held that his retirement was unauthorized, and he was put on the list of contributories ten years after his shares had been cancelled.[5] - - - - The directors of a company disagreeing as to the mode of managing its affairs, and being divided into two parties, it was resolved that one of the two parties should retire, and that the other should take the management of the company and relieve the first from their liabilities. The directors composing one of

[1] Hall's Case, L. R. 5 Ch. 707; Adams' Case, L. R. 13 Eq. 474.

[2] Cartmell's Case, L. R. 9 Ch. 691.

[3] Lind. Comp., 5th ed., p. 518–20.

[4] Morgan's Case, 1 De G. & S. 750; *s. c.* 1 Mac. & G. 225. Richmond's Executor's Case, 3 De G. & Sm. 96 and Lawes' Case. 1 De G. M. & G. 421, were similar decisions with respect to other shareholders in the same company. Compare Kent *v.* Jackson, 14 Beav. 367; *s. c.* 2 De G. M. & G. 49.

[5] Stanhope's Case, 3 De G. & S. 198. See too Esparto Trading Co., 12 Ch. D. 191; Daniell's Case, 22 Beav. 43; aff'd 3 Jur. (N. S.) 803; Walter's Case, 3 De G. & S. 244; Holt's Case, 1 Sim. (N. S.) 389. Compare Cockburn's Case, 4 De G. & S. 177, and Busk's Case, 3 *Id.* 267; and observe the larger powers of the directors in the first, and the adoption of their acts in the last of these two cases.

the two parties did accordingly retire, and relinquish their shares in favor of the company; but it was held that their retirement was altogether unauthorized and invalid, and that they were contributories on the winding up of the company.[1] - - - - The principles laid down in these cases were very much considered in the course of winding up the Agriculturist Cattle Insurance Company. The company was formed in 1845. In 1848 it had got into difficulties, and several shareholders wished to retire. This they could not do consistently with the company's deed of settlement. An arrangement, however, was made in November, 1848, under resolutions passed at a meeting of shareholders specially convened for the purpose, to the effect that a call for £4 per share should be made, and that those shareholders who wished to retire should, on a particular day, pay part only of the call, and that their shares should be forfeited for non-payment of the rest. Under this arrangement many persons retired at once; many, however, remained and of those some retired afterwards under various arrangements made between themselves and the directors. In 1861 the company was ordered to be wound up, and in the course of such winding up it was held: 1. That having regard to the publicity and *bona fides* of the arrangement come to in November, 1848, and to the time which had since elapsed, the validity of the retirement of those shareholders who withdrew in pursuance of that arrangement could not be disputed, and that those persons therefore were not liable to be placed on the list of contributories.[2] 2. That those persons who retired afterwards by arrangement with the directors, but without the knowledge of the other shareholders, were to be treated as shareholders still, and were liable to be placed on the list, although twelve years had elapsed since their retirement and the winding-up order." [3]

§ 1524. What Cancellations Good as to Future Creditors.— A number of cases proceed on the view that the release of subscribers and other shareholders is not good as to *existing creditors*,[4]

[1] Munt's Case, 22 Beav. 55. See too Bennett's Case, 18 Beav. 339; *s. c.* 5 De G. M. & G. 284; Richmond's Case, and Painter's Case, 4 K. & J. 305.

[2] Evans *v.* Smallcombe, L. R. 3 H. L. 249; Brotherhood's Case, 31 Beav. 365; aff'd 4 De G. F. & J. 566.

[3] Spackman *v.* Evans, L. R. 3 H. L. 171; Houldsworth *v.* Evans, *Id.* 263; Stanhope's Case, L. R. 1 Ch. 161; Stewart's Case, *Id.* 511.

[4] In pursuance of this idea, it has been held, in an action by a corporation against a subscriber to its capital stock for an assessment, that a plea by the defendant that he had been released from his liability on his subscription by a resolution of the board of directors of the company, must aver not only that there was a consideration to support the resolution, but also that the company, at the time of the alleged release, was *not in debt*, as

though it may be good as to *future creditors.*[1] On this subject there are several exceedingly loose and ill-considered cases. The Supreme Court of Alabama has held that a resolution *by the directors* of a railroad company, that the stockholders might relinquish one-half of their stock, and the payments previously made be accounted for as if made on the stock retained, provided the stockholders paid all the calls subsequently made by the directory, is in the nature of a contract entered into between the corporation and its members, and is not on its face illegal or improper.[2] A decision of the Supreme Court of Iowa states the doctrine even more broadly, by saying that a *contract* made by an agent of a railroad corporation, by which it undertakes to release a subscriber from his subscription, is valid without the consent of shareholders, it not appearing that the company has any creditors.[3] But the same court holds in a subsequent case that such an arrangement cannot be made to the prejudice of creditors.[4] Analogous to this case was one decided by Mr. Circuit Judge Dillon. The charter of a railroad company provided that five per cent. on each share should be paid when subscribed, and subsequent payments be made upon calls. The stockholders voted that no further calls be made; that certificates

the corporation could not make such release to the injury of its creditors. Zirkel *v.* Joliet Opera House Co., 79 Ill. 334. One of the earlier cases in Mississippi seems to embody the same idea. The court holds that where a party subscribes for a certain number of shares of stock in a bank, and does everything that is necessary in order to secure his right to the stock, but does not fully pay it up, he cannot afterwards, by an agreement with the bank, diminish the number of his shares, so as to affect the rights of existing creditors of the bank; and in a contest between such stockholder and a judgment creditor of the bank, the former cannot avoid his obligation to pay up all the stock for which he originally subscribed, by proof that the number of his shares has been reduced by agreement with the directory, unless he shows, affirmatively, that such reduction took place *before the claim of the creditor originated.* Payne *v.* Bullard, 23 Miss. 88; *s. c.* 55 Am. Dec. 74. These decisions seem to involve the concession that, if there are no creditors, the directors, as the representatives of the other shareholders, can release a subscriber from his obligation to pay according to his contract. The writer submits for reasons and upon authorities already given (*ante,* § 1521), that this cannot be done by the directors, even as against stockholders, unless they have been clothed with such power either by the governing statute or by the shareholders themselves.

[1] See *post,* § 1535.

[2] Cooper *v.* Frederick, 9 Ala. 738.

[3] Gelpcke *v.* Blake, 19 Iowa, 263.

[4] Singer *v.* Given, 61 Iowa, 93.

issue for stock to the extent to which payment had been made, and that the balance of the subscriptions be cancelled. This vote was carried out while the company was solvent. Seven years after, when the company was bankrupt and practically dissolved, certain of its creditors sought to make the parties released liable as stockholders for unpaid subscriptions. The learned judge held that said parties had been released from all such liability.[1] These decisions contain the obvious suggestion that in considering the validity of a release of shareholders in respect of the rights of creditors, a distinction must be taken between those acts which are not expressly authorized by the governing statute, and those measures which the company may be so authorized to take for the purpose of *reducing its capital stock*.[2]

§ **1525. Further of this Subject.** — Some of these decisions seem to illustrate an entire incapacity to understand the true office of the directors of a business corporation, which is merely that of business managers. Certainly the directors of a corporation have no such power, as against its creditors, unless it has been expressly conferred upon them by the governing statute, nor as against its shareholders unless it has been conferred upon them by such shareholders and then by unanimous consent.[3] If this can be done as against creditors, a corporation may organize and go upon the public records as having a certain capital stock, and on the faith of this it may acquire credit and continue to contract debts while at the same time, by secret arrangements, unknown to the public, it may release its assets to its subscribers and hollow itself into a mere shell, and then dissolve, leaving its creditors in the lurch. But where the subscription to the capital stock has never been made public, this element of estoppel does not, at least to the same extent, enter into such a case. Under such circumstances it has been held that an arrangement made in good faith among the shareholders before the corporation has incurred debts, whereby, instead of issuing stock to the amount of the original subscriptions, each subscriber is given full paid-

[1] Steacy *v.* Little Rock &c. R. Co., 5 Dill. (U. S.), 348.

[2] *Post*, § 2114, *et seq.*

[3] *Ante*, § 1521.

up stock to the amount that he has actually paid on his subscription, is valid, as against creditors, and they cannot enforce the original subscriptions, except as to the difference between the amount of paid-up stock so issued and the minimum allowed by the charter for the transaction of business.[1] In another case one who had agreed to take stock in a corporation withdrew and was released and his cash installment was never paid or demanded during the life of the corporation; it was held that he was not liable to an assessment by the assignee in bankruptcy of the company twelve years later, although his name appeared on the stock books of the company.[2] Nor does this principle extend so far as to prevent the corporation from cancelling stock that has been *wrongfully issued*, — as where stock has been issued as a *stock dividend*, under pretense that the earnings of the corporation justify such a dividend, when such is not the fact.[3]

§ 1526. No Rescission after Insolvency. — Although it is frequently said that *fraud* vitiates all contracts, yet we have seen that after the corporation stops business by reason of insolvency, a subscriber cannot rescind his contract of subscription even on the ground that it was obtained from him by fraud.[4] If after insolvency there can be no rescission on the ground of fraud, it is safe to say that there can be none on any ground unless it be on some ground the effect of which is that the contract was void *ab initio* and incapable of affirmance or ratification. It may therefore be stated with confidence that the general rule is that after the insolvency of the corporation such a contract cannot be rescinded so as to effect the rights of creditors.[5]

§ 1527. Release or Modification of Conditional Subscriptions.— But where the contract contains mutual covenants, and it

[1] Hill *v.* Silvey, 81 Ga. 500; *s. c.* 3 L. R. A. 150; 39 Alb. L. J. 316; 8 S. E. Rep. 808.

[2] Cook *v.* Chittenden, 25 Fed. Rep. 545. He made the subscription on an agreement with the agent, that he should be allowed to withdraw before the agent left town. He elected to withdraw, and the agent agreed to release him, but his name was nevertheless put upon the stock book. Compare *post*, § 1544.

[3] Hollingshead *v.* Woodward, 35 Hun (N. Y.), 410.

[4] *Ante*, § 1450.

[5] Putnam *v.* New Albany, 4 Biss. (U. S.) 365.

becomes either impossible or disadvantageous for the corporation to perform them on its part, and the parties to the contract thereupon elect to rescind it, no reason is perceived why this should not stand good, even as against creditors. Thus, if the subscription is conditional, as that a tramway shall have a certain extension, and the extension is obtained, the subscriber may be released by the other stockholders, provided they act in good faith.[1] And a resolution on the part of directors which merely has the effect of reducing or modifying the obligation of the subscriber according to the terms of the *condition* in his subscription, acquiesced in at the time by all parties, will not, after the lapse of a great length of time, be disturbed.[2] It is, of course, no defense in an action by the corporation for an assessment that, after the subscription was made, it was *modified* by agreement of the parties, so as to make it more favorable to the corporation, — as where the subscription had been made on the condition that $800,000 should be subscribed by others, and it was so modified as to reduce the same to $700,000.[3]

§ 1528. **Where the Company Makes Radical Changes in the Original Project.**— On a similar principle, where the company makes a radical departure from the object which it was organized to promote, such as may be regarded within the principles already stated,[4] as a breach of the contract on the part of the corporation, whereby he acquires the legal right to withdraw from the enterprise, of course it is competent for the directors to release him, since he may elect to release himself without their authorization.[5]

§ 1529. **Refusal to be a Shareholder at All.** — On like grounds the obvious distinction must be kept in mind between the case where a shareholder is released who might have been held by the company, and where there is a retirement of supposed

[1] Nettles *v.* Marco, 33 S. C. 47; *s. c.* 11 S. E. Rep. 595.

[2] Putnam *v.* New Albany, 4 Biss. (U. S.) 365.

[3] Emmitt *v.* Springfield &c. R. Co., 31 Ohio St. 23.

[4] *Ante*, § 71 *et seq*; § 1262, *et seq.*

[5] Meyer's Case, 16 Beav. 383.

shares through the refusal of the supposed shareholder to receive them, when in fact he never agreed to receive them.[1]

§ 1530. Releasing Shareholder Whose Name is not on the Register. — But a shareholder cannot claim to be released, from the mere fact that his name has not (in England) gone on the register. In a case arising under a clause in articles of association which provided that "the directors may, if they think fit, accept the surrender or forfeiture of his shares by any shareholder desirous of surrendering or forfeiting them, on such terms as the directors may think fit," a subscriber of the memorandum of association of the company, who was also a director, applied for the number of shares for which he had subscribed, and paid the deposit on them. Before any shares had been allotted to him, or his name had been entered on the share-register, he withdrew from the office of director and applied to have his application for shares cancelled. The directors cancelled the application and returned the deposit. It was held (reversing the decision of the Master of the Rolls) that it was not material that this subscriber had not been entered as a member on the register of members, which, in strictness, ought to have been done, and that for all purposes of the act he was a shareholder, and ought not to be made a contributory.[2]

§ 1531. Release of Unallotted Shares. — But where the articles of association contained a provision similar in all respects to that just recited, and, further, a clause prohibiting the board of directors from purchasing or dealing in any shares of the company, it was held to be an act *ultra vires* of the directors and the company to release one of the board from all liability with respect to two hundred and fifty shares, which had not been allotted to him, of five hundred shares subscribed for by him in the memorandum of association. A deed of release and indemnity in respect of such shares was not an acceptance of a surrender and forfeiture under the articles of association, but was a dealing in shares by the company.[3]

[1] Lind Comp. L., 5th ed., p. 520–21; citing Pim's Case, 3 De Gex & Sm. 11; *s. c.* 1 Mac. & G. 291; Hennessey's Case, 2 Mac. & G. 201; *s. c.* 3 De Gex & Sm. 191. See also Downes *v.* Ship, L. R. 3 H. L. 356, 358; Blackburn's Case, 3 Drewry, 409; Rye's Case, 3 Jur. (N. S.) 460; Stewart's Case, L. R. 1 Ch. 574; Webster's Case, L. R. 2 Eq. 741; Anderson's Case, 17 Ch. Div. 373; Re Scottish Petroleum Co., 23 Ch. Div. 413; Compare Smith *v.* Chadwick, 20 Ch. Div. 27; *s. c.* 9 App. Cas. 187; Hallows *v.* Fernie, L. R. 3 Ch. 467. Most of these cases relate to the question in English company law of a *variance between the prospectus and the memorandum*, as to which see *ante*, § 1444, *et seq.*

[2] Snell's Case, L. R. 5 Ch. 22.

[3] Hall's Case, L. R. 5 Ch. 707.

§ 1532. Where there is Power to "Alter, Rescind, or Abandon Contract." — However, a similar transaction was held to be not *ultra vires* of the board of directors when, by the articles of association, they were empowered "to enter into, alter, rescind, or abandon contracts in such manner as they should think fit," and moreover, the company, by another provision, was permitted to *decrease its capital* by reduction or cancellation of unissued or forfeited shares. A person had agreed to take 1,000 shares, at the rate of fifty shares per month, on the faith of his position as secretary of the company. He continued so to take shares until he had taken eight hundred and fifty in number, when he resigned his position as secretary, for which he received a salary of £105 per annum, in consideration of being relieved from further payments of the remaining one hundred and fifty shares which he had agreed to take, and a resolution of the board of directors was passed in accordance therewith. The Master of the Rolls was of the opinion that under the article set forth the board of directors had power to relieve the subscriber in respect of his contract for shares, and that they had done so.[1]

§ 1533. Where Directors have no Express Power to Accept Surrenders. — But where the articles of association vested no power in the board of directors to accept a surrender of shares, the following circumstances were held not to constitute one of the excepted cases to the ordinary rule that if persons sign a memorandum of association, and nothing has been done to relieve them of the responsibitity they are under in consequence of so doing, they must be placed upon the list of contributories. Upon the formation of a company, nine persons signed the memorandum of association. At a preliminary meeting a resolution was passed that no shares be allotted to three of the subscribers to the articles, and with their consent, the deposit-money was repaid to them. None of their names were entered on the register of members, nor were they afterwards in any way connected with the company. In opposition to the application to have these subscribers placed upon the list of contributories, the counsel relied upon Snell's case;[2] but Malins, V.-C., pointed out that in Snell's case the subscriber to the memorandum was removed from the list of contributories, not for the reason that he had not been a shareholder (because it was said expressly that he was), but that he had ceased to be so upon the strict exercise of the power vested in the directors to accept the surrender of the shares. The subscribers in question were therefore placed upon the list of contributories.[3]

[1] Thomas' Case, L. R. 13 Eq. 437.

[2] L. R. 5 Ch. 22.

[3] Re London & Provincial Consolidated Coal Co., 5 Ch. Div. 525.

§ 1534. Influence of the Equitable Doctrine of Laches. — It is obvious that several of the decisions which have been considered have been influenced more or less by the equitable doctrine of *laches*, although that may not be expressed in the opinion of the court. The lapse of twelve years in one case,[1] and fifteen in another,[2] have suggested to the judges the inequity of disturbing settlements which, although wrongful at the time, could not be righted so as to put the parties *in statu quo*. Nor would it be establishing justice to set up rights so old, drowsy and decayed.[3]

§ 1535. Effect of the Company Taking the Shares Back and Re-issuing Them. — Suppose the company takes the shares back, and afterwards procures for them at the same price a new and solvent purchaser, and issues them to him. In such a case it is difficult to see how either the shareholders or the creditors, if there are any, are prejudiced, unless, as suggested in a former section, the shareholders may have subscribed on the faith that the person originally subscribing was to be a co-adventurer in the enterprise, and that it was to have the benefit of his skill, experience, reputation and the like. It has accordingly been held that one who surrenders to the corporation shares of stock which have been issued to him as "full paid," but for which nothing in fact was paid, which stock the corporation afterwards re-issued, for value to a solvent taker, is not liable to one who becomes a creditor *subsequent* to the surrender.[4] So, obviously the stock of a corporation fully paid for may lawfully be returned to the company or to a trustee for its benefit, to be sold or donated to

[1] Cook *v.* Chittenden, 25 Fed. Rep. 545.

[2] Putnum *v.* New Albany, 4 Biss. (U. S.) 365.

[3] As to the influence of laches on illegal forfeitures, see *post*, § 1798.

[4] Erskine *v.* Peck, 13 Mo. App. 280; *s. c.* affirmed, 83 Mo. 465. In the later case of Johnson *v.* Lullman, 15 Mo. App. 55, *s. c.* affirmed 88 Mo. 567, it was held that a stockholder who surrenders unpaid stock to the corporation is not liable to a creditor whose demand accrued *after* the surrender, without reference to the question whether it was re-issued by the corporation to solvent purchasers. While the writer regrets to find himself concurring on the record in these observations, it should be added that it was not necessary to the decision, which really turned on another point and should not have been made. It is believed that this is not the law. *Ante*, § 1524.

subscribers to the corporate bonds, without creating any liability upon the stock on the part of the bondholders.[1] The Supreme Court of Illinois have held that where corporate stock has been subscribed for, but not taken up, and is afterwards transferred to the company, and is by the company sold to a third person at less than its face value as "treasury stock," the original subscribers are liable for the difference between what the corporation actually obtained for it and its face value.[2] Another court has held that an attempt to release a stockholder from his contract by the general manager of a corporation, who is also the largest stockholder, secretary and treasurer, on the stockholders request, that he would dispose of his stock, whereby he causes entries to be made on the books charging off the balance due for unpaid calls, and crediting to the stockholder the sums paid by him, will not avail to release the stockholder, where no attempt is made to transfer his shares, although the manager secures new subscriptions to the stock in place thereof, and both parties suppose that he is authorized to substitute new subscriptions and release the old ones. If injured, his remedy is one against his agent, the manager.[3]

§ 1536. No Division of the Corporate Property Among Shareholders Before Dissolution. — Under the Civil Code of California, § 309, a corporation cannot, prior to its dissolution, distribute its capital stock to its shareholders;[4] and beyond question such is the rule of law without the aid of any statute.

§ 1537. Release where there has been a Transfer of Shares. — As we shall hereafter see, if the subscriber is indebted for his shares, in the absence of circumstances which place a purchaser of them in the category of *bona fide purchasers without notice*, such purchaser succeeds to the liability to pay the debt. The debt runs with the shares, so to speak, unless the governing statute or a valid by-law otherwise provides.[5] But if

[1] Davis *v.* Montgomery Furnace &c. Co. (Ala.), 8 So. Rep. 496.

[2] Alling *v.* Wenzel, 133 Ill. 264; *s. c. sub nom* Alling *v.* Ward, 24 N. E. 551; 8 Rail. & Corp. L. J. 124.

[3] Cartwright *v.* Dickinson, 88 Tenn. 476; *s. c.* 7 L. R. A. 706; 12 S. W. Rep. 1030.

[4] Kohl *v.* Lilienthal, 81 Cal. 378; *s. c.* 22 Pac. Rep. 689; 6 L. R. A. 520.

[5] *Post*, §§ 1680, 2335, 3241.

the stockholder has settled for his shares, that is to say *paid* for them, by giving his promissory note to the company, then the purchaser takes them free of liability. The acceptance of the note by the company ordinarily releases its lien on the shares, and they thereby become "paid-up shares." If, in such a case, the original subscriber, who has given his note to the company in payment of his shares, and who has afterwards transferred them to another, attempts to substitute the credit of that other for his own, this, it seems, can be done in the absence of fraud, and provided the transferee is solvent and capable of taking.[1] While the author finds no direct authority on this point, no reason is perceived why one solvent creditor could not, by agreement with all the parties, acting in good faith, be substituted for another. An English case has been found which supports the author's suggestion. A person agreed to take shares in a company incorporated under an act of Parliament providing that the company should not issue any share, nor should any share vest in the person accepting the same, unless at least one-fifth of the amount of the share had been paid. Under the agreement twenty-five shares of £20 each were issued to the applicant, and he gave his check to the secretary of the company for £100; but this check was never presented to the bankers, nor was any payment ever made by the shareholder in respect of the shares. After holding these shares for over a year, he transferred them, which transfer was duly registered, and the name of the transferor was removed from the register of shareholders. The company was subsequently ordered to be wound up, and the name of the transferor was placed upon the list of contributories. On an application to rectify the list, the lord chancellor (Selborne) stated that if the first holder of these shares paid £100 upon them the transfer was valid. If this payment was not made, the transfer was invalid, for the shares did not vest. Could he, then, be made a contributory by reason of his *agreement* to take shares? This agreement rested wholly *in fieri*, and was capable of being discharged by a fresh agreement. The transfer, having been accepted by the company, was such an agreement, operating as a new contract between the transferor, the transferee, and the

[1] *Post*, §§ 3231, 3255.

company. The original holder of the shares was therefore discharged from liability as a contributory.[1]

§ 1538. **Release by Act of the Creditor.** — While as between the subscriber and the corporation, *e. g.*, in an action for calls, a release can only be shown by the act of both parties,[2] yet as against a creditor whose rights have accrued it seems clear that there can be no release without his consent. If, after the retiring of a stockholder from the corporation by the sale of the stock, and due notice thereof as required by the charter, the creditor gives up old notes upon which the stockholder was liable and takes new ones, especially if done for the purpose of absolving him from liability, and imposing it upon his successor in the stock, this operates as a complete release to him, both at law and in equity.[3]

§ 1539. **When Release of One Stockholder by a Creditor no Release of the Others.** — Where the liability of the stockholders is *several* and not *joint* — and this is nearly always the case — a release by a creditor of one shareholder, does not operate as a release of the others.[4] It is not like releasing one of several joint trespassers.

§ 1540. **Revocation by Default or Neglect of Commissioners.** — Decisions which turn on the conduct of the commissioners appointed to take subscriptions and to organize corporations are now nearly obsolete; because, under the general statutes existing in most of the States, permitting the organization of corporations, they are seldom organized by the aid of such functionaries, yet it may not be amiss to allude to the rule that a contract of subscription taken by such commissioners is not avoided by their subsequent neglect to perform, within the time prescribed by the act, some other duty devolved upon them by the governing statute, which is in its nature directory, *e. g.*, the duty of giving

[1] Morton's Case, L. R. 16 Eq. 104.

[2] Stuart *v.* Valley R. Co., 32 Gratt. (Va.) 146.

[3] New England &c. Bank *v.* Newport, 6 R. I. 154; *s. c.* 75 Am. Dec. 688.

[4] Bank of Poughkeepsie *v.* Ibbotson, 5 Hill (N. Y.), 461. Compare Robinson *v.* Bealle, 20 Ga. 275.

notice to choose directors as soon as the given number of shares is subscribed.[1]

§ 1541. Refusal by the Corporation to Receive the Subscription. — It is not intended to enter here into the question under what circumstances the corporation may, after being called into existence, reject the subscriptions of any of those who have called it into existence, if at all. If it does so, not colorably and collusively but in good faith, its assignee in the event of its insolvency will be bound by its action. He will not be allowed to disaffirm it and compel payment of the subscriber; but the obligation is extinguished.[2]

§ 1542. Refusal to Sign Articles of Association after Signing Preliminary Contract. — As already seen,[3] there are two theories on this question: One is that there is a *locus pœnitentiæ* — a power of rescission at any time before the final articles of association or other formal compact prescribed by the governing statute is signed.[4] The other, and the only one consistent with honesty and fair dealing, is that after the subscriber signs the preliminary paper, and others also sign, he is bound to them and they are bound to him, and he cannot escape the obligation of his contract by refusing to sign the final paper.[5]

[1] Union Turnpike Co. *v.* Jenkins, 1 Caines (N. Y.), 381, 390.

[2] Potts *v.* Wallace, 32 Fed. Rep. 272.

[3] *Ante*, § 1162.

[4] One who subscribed for stock in a company chartered but not organized, the charter providing for subscription before organization, was held to his subscription unless he expressly dissented before the charter was accepted. Gleaves *v.* Turnp. Co., 1 Sneed (Tenn.), 491.

[5] On this theory it was held that while a subscriber to the preliminary articles might refuse to sign the final articles which were to be recorded, yet when the necessary number of signers to this final paper was obtained, and the same recorded and the corporation thus called into existence, it might enforce the contract of subscription against the subscriber. Johnson *v.* Wabash &c. Co., 16 Ind. 389. Another court has held that the representative of creditors may do the same thing after the corporation becomes insolvent. Haskell *v.* Sells, 14 Mo. App. 91. As to the validity of subscriptions to enterprises where there is not the strict element of a contract for want of contracting parties, see Swain *v.* Hill, 30 Mo. App. 436; Underwood *v.* Waldron, 12 Mich. 73; Bryant *v.* Goodnow, 5 Pick. (Mass.) 228; Trustees *v.* Allen, 14 Mass. 172; *s. c.* 7 Am. Dec. 201; Griswold *v.* Trustees, 26 Ill. 41; *s. c.* 79 Am. Dec. 361. That subscriptions to the capital stock of corporations not

§ 1543. The English Doctrine on this Subject. — This is quite conformable to the English doctrine as to the effect of signing the provisional paper which in that country is called the memorandum of association, where the name of the signer, in consequence of some effort or agreement of rescission, never goes upon the permanent register of shareholders. The circumstances of Levick's case[1] furnish an illustration of one of the strictest applications of the liability growing out of a simple subscription to a memorandum of association. Levick signed the memorandum of association of a company for fifty shares, in January, 1866. The company was registered on January 18, 1866. Directors were appointed on February 24, 1866. The company was wound up on September 23, 1867. No shares were ever allotted to him in respect of his subscription. He made no application for shares, except as above mentioned, and never acted as a director of the company. The vice-chancellor, under this statement of facts, indicated that, during the period from the registration of the company to the appointment of the directors, the effect of the signing of the memorandum was to make the subscriber a director until another board of directors was appointed, and that it was the duty of Mr. Levick, as such director, or of the subsequently appointed board, to place his name upon the list of shareholders. Neither the counsel nor the court, in this case, were aware of any case in which a person who had signed a memorandum of association for any number of shares did not become absolutely bound to take those shares, no delay operating as a bar to putting the name on the register of shareholders. The twenty months' delay, therefore, from the formation of this company to the winding-up, could not relieve the subscriber from liability. The decision was placed upon grounds of policy as well as of principle, viz.: that persons should know that they cannot subscribe a memorandum of association to form a company, and become members of it, without

yet in existence become binding when action is taken on the faith of them,— see *ante*, § 1175; Hamilton *v.* Rice, 7 Barb. (N. Y.) 157; Stanton *v.* Wilson, 2 Hill (N. Y.), 153; Shober *v.* Lancaster &c. Asso., 68 Pa. St. 429; Edinboro Academy *v.* Robinson, 37 Pa. St. 210; *s. c.* 78 Am. Dec. 421; New Lindell Hotel Co. *v.* Smith, 13 Mo. App. 7.

[1] 40 L. J. (Ch.) 180.

incurring the responsibility of shareholders. The principles enunciated in Levick's case had a striking application in Sidney's case,[1] on account of the greater lapse of time from the formation of the company to the winding-up, and the distinct and positive withdrawal of the subscriber from the company. The circumstances were that, in 1865, Sidney agreed to become a director of a company, and signed the memorandum for two hundred shares. The articles of association empowered the directors to decline to commence business unless two-thirds of the capital were subscribed. Sidney having unsuccessfully opposed a resolution to commence business, notwithstanding two-thirds of the capital had not been subscribed, on January 3, 1866, his resignation as director was accepted, and his name was never placed upon the list of shareholders. In February, 1870, the company was ordered to be wound up; and, there being a large number of unallotted shares, Sidney was placed on the list of contributories for the two hundred shares as originally subscribed for by him. This action was sustained by the court on the principle of Levick's case; the court saying that there was no way of getting rid of the liability incurred by signing the memorandum of association except by taking the shares and then making a valid transfer.[2]

§ 1544. Erasure or Revocation of the Subscription Before Delivery. — A contracting party cannot, of course, destroy the obligation of his contract by destroying the written evidence of it, provided there has been a delivery, or provided that something has taken place which is tantamount to a delivery. The erasure of a contract of subscription does not, therefore, prevent a suit to charge the party as a subscriber, but merely lets in parol evidence in explanation of the circumstances.[3] It has been held that the authority of an agent appointed to receive subscriptions to the stock of a company is exhausted by the act of receiving the subscriptions. The subscription instantly inures to the benefit of the company, creating a contract between it and the subscriber, which the agent cannot rescind. Notice to the agent in such a case, of the intention to revoke the subscriptions, is a

[1] L. R. 13 Eq. 228.

[2] Levick's Case, 40 L. J. (Ch.) 180.

[3] Johnson *v.* Wabash &c. Co., 16 Ind. 389.

mere nullity.[1] There are many cases of agency which are quite analogous to this, — where the agent has power to do a thing, but not the power to undo it. Thus, an agent to effect the sale of real estate is not, in the absence of express authority to that end, an agent for the purpose of rescinding a sale which he has effected.[2] But if the agent has no authority to receive the subscription, but nevertheless assumes to receive it, the subscription, until it is handed into the company by such pretended agent, is in the nature of a declaration of a purpose by the subscriber, made to a mere stranger, or perhaps of a delivery of a proposition to the company for a contract by the subscriber to his own agent; and he may therefore revoke it and discharge himself of all obligation under it before it is handed to the company and accepted by it.[3]

§ 1545. **Whether a Release of One Subscriber Discharges Other Subscribers.**— On this question there are opposing ideas, and both of them are supported by some reason. If, as we have seen,[4] a contract of subscription signed by several persons becomes, so to speak, a multi-partite contract, so that each one has the right to insist that every other one shall be held to the performance of his engagement, and that some shall not be allowed to withdraw and leave others to shoulder the burden,— it would seem to follow that if some are allowed to withdraw all the others are released who do not consent thereto; and so it has been held in some cases.[5] But this reasoning seems to prove too much. It is difficult to see how it could be applied, except possibly to a release of the shareholder which might take place at a general stockholders' meeting and by the vote of a majority of the stockholders. The corporation, in an artificial sense and the directors in a substantial sense, are trustees for

[1] Lowe *v.* Edgefield &c. R. Co., 1 Head (Tenn.), 659.

[2] Recognized in Birge *v.* Bock, 44 Mo. App. 69.

[3] Lowe *v.* Edgefield &c. R. Co., 1 Head (Tenn.), 659. Compare Lancaster *v.* Elliott, 28 Mo. App. 86.

[4] *Ante*, § 1270 *et seq.*

[5] McCully *v.* Pittsburgh &c. R. Co., 32 Pa. St. 25, 31; County of Crawford *v.* Pittsburgh &c. R. Co., 32 Pa. St. 141. (In this case the managers released the other subscribers before they procured the subscription in controversy, which was a municipal subscription.) Rutz *v.* Esler &c. Man. Co., 3 Ill. App. 83.

the shareholders. If in the execution of this trust they assume to release a shareholder, they do it either with or without lawful authority. If they have lawful authority to do it, then it is not perceived how the doing by them of what is lawful can afford ground for discharging subscribers who do not consent to it,[1] unless there is a proviso annexed to the authority of the directors by which the assent of the stockholders is required, — which is tantamount to saying that the directors have no lawful authority to do the act themselves. If, on the other hand, the directors have no lawful authority to release the particular subscriber, then the release is void and he is still bound, and their attempted release of him affords no ground on which dissenting stockholders can claim that they are released. Moreover this doctrine is as weak in logic as it would be disastrous in consequences, if allowed to prevail. For it would follow that a single mistake or breach of trust on the part of the directors in releasing a single subscriber might explode the corporation like a puff-ball, by furnishing a pretext to all the other subscribers to recede from their engagements, either discharging part of them to the prejudice of those who might feel bound to remain or else scattering its assets to the winds, perhaps to the prejudice of creditors. It is therefore not surprising that courts are found reluctant to admit so dangerous a doctrine, though they have often evaded it on various indirect grounds, instead of planting themselves on the contract above stated. One such court has held that in absence of fraud or injury, one subscriber is not discharged by the fact that the directors have settled the indebtedness of another subscriber upon his subscription, by his allowing it against an indebtedness of the corporation to him.[2] The same court, in another decision rendered about the same time, has condensed its reasoning in this way, in its official syllabus: "A subscriber to shares in a corporation contracts with reference to

[1] This is well illustrated by a case where the by-laws of an insurance company vested all the corporate power in the board of directors and authorized them to cancel such of its stock as they should deem worthless. It was held that they had power to cancel premium notes, and consequently that an assessment made on the amount of the remaining notes, after the cancellation was made by them, was valid. Maine &c. Ins. Co. *v.* Neal, 50 Me. 301; see *post*, § 1547.

[2] Macon &c. R. Co. *v.* Vason, 57 Ga. 314. As to this right of set off, see *post*, § 3785, *et seq.*

the charter; and the number of shares to be subscribed, or the whole capital stock necessary to do the contemplated business, constitutes an important element in the contract." For the corporation to release subscriptions so as to reduce the capital largely and materially, may operate as a release of other subscribers. "A mere nominal subscription, to fulfill the letter and break the spirit of the contract, is no substantial compliance with the charter, and, when released because it was nominal, it becomes equivalent to no subscription *ab initio*."[1] The Supreme Court of New York held that it was no defense to an action to recover the amount of a subscription to the capital stock of a corporation, that before the filing of the articles of association, the name of one of the subscribers was erased, it being fairly inferable from the evidence that the erasure was made with the knowledge of the defendant, of all the directors, and at the request of the person whose name was erased, the evidence showing also that the erasure was made without fraudulent intent.[2] Another court has held that a *compromise decree* making an offer of terms of settlement to all alike who are liable on the stock of an insolvent corporation, does not release those who do not accept it, from their liability on the stock.[3]

§ 1546. Fraudulent Withdrawal of Premium Notes Given to Mutual Insurance Company. — The premium notes given by members of mutual insurance companies under the New York statute of 1849, ch. 308, are deemed to constitute a fund for the security of creditors, in lieu of capital stock; they are payable absolutely, and may be collected without any allegation of losses, and without an assessment;[4] hence an agreement made

[1] Memphis Branch R. Co. *v.* Sullivan, 57 Ga. 240. By the law of Georgia the syllabus is the official declaration of the law by the court: the opinion is only the reasoning of the particular judge.

[2] Plank Road Co. *v.* Wetsel, 21 Barb. (N. Y.), 56.

[3] Hambleton *v.* Glenn, 72 Md. 331, 351; *s. c.* 8 Rail. & Corp. L. J. 372; 20 Atl. Rep. 115.

[4] Furniss *v.* Gilchrist, 1 Sandf. S. C. (N. Y.) 53; Brouwer *v.* Hill, 1 Sandf. S. C. (N. Y.) 629; Brouwer *v.* Appleby, 1 Sandf. S. C. (N. Y.) 158; Hone *v.* Allen, 1 Sandf. S. C. (N. Y.) 171; Hone *v.* Folger, 1 Sandf. S. C. (N. Y.) 177; Caryl *v.* McElrath, 3 Sandf. S. C. (N. Y.) 176; Deraismes *v.* Merchants' Mutual Ins. Co., 1 N. Y. 371; Howland *v.* Myer, 3 N. Y. 290; Brown *v.* Cooke, 4 N. Y. 51; Emmett *v.* Reed, 8 N. Y. 312; White *v.* Haight, 16 N. Y. 310.

by the president of such a company, on receiving such a note, that it should be given up at maturity,[1] or that another note of less value should be substituted for it,[2] has been held void. If such a note passes to a receiver of the company, he may sue and recover on it;[3] if it has been given up to the maker, in pursuance of such an agreement, the receiver may maintain trover for it against the maker,[4] who may sue and recover its amount.[5] In such a case, where it appeared that the principal object of giving the note was to take out a large policy, on which to vote for trustees at an approaching election; that it was given with an intent and expectation by the maker that it would appear in the company's annual statement as one of the assets, and figure as one of the securities held for the protection of dealers, and it did so appear with the maker's knowledge; and the jury found that it was not an open policy note given in reference to business; — it was held that the maker was liable on it to the company, as a note held for the security of its dealers, and that it must be regarded in law either as a note lent by the maker to the company for that purpose, or as a note given under the charter provision in that behalf.[6] So, where a joint-stock insurance company desired to reorganize on the mutual plan, and it was necessary, under the statute, to exhibit to the comptroller notes given in advance of premiums to the extent of $100,000, and a note was given for the purpose of enabling the company to exhibit this amount of assets to the comptroller, and so pass the necessary examination, with the secret understanding that it should be returned to the owner and a note of lesser amount substituted for it, which was afterwards done, — this transaction was held to be a fraud upon the law, and the makers of the fictitious note continued liable thereon, although it had been delivered up and destroyed.[7]

[1] Brouwer *v.* Appleby, 1 Sandf. S. C. (N. Y.) 158; Hone *v.* Allen, 1 Sandf. S. C. 171; Brouwer *v.* Hill, 1 Sandf. S. C. (N. Y.) 629.

[2] Tuckerman *v.* Brown, 33 N. Y. 297; *s. c.* 88 Am. Dec. 386.

[3] Brouwer *v.* Appleby, 1 Sandf. S. C. (N. Y.) 158.

[4] Brouwer *v.* Hill, 1 Sandf. S. C. (N. Y.) 629.

[5] Tuckerman *v.* Brown, 33 N. Y. 297; *s. c.* 88 Am. Dec. 386.

[6] Brouwer *v.* Hill, 1 Sandf. S. C. (N. Y.) 629.

[7] Tuckerman *v.* Brown, 33 N. Y. 297; *s. c.* 88 Am. Dec. 386.

§ 1547. Withdrawal of Members of Building and Mutual Fund Associations. — Building and other mutual fund associations stand on a footing, in respect of what we are considering, different from that occupied by ordinary joint-stock companies. Their schemes of organization often provide for the withdrawal of members on giving a prescribed notice,[1] and on complying with other conditions. Building associations do not allow their stockholders to withdraw, thereby escaping assessments where their stock is incumbered; and it has been held that such stock is incumbered where there is a judgment against the stockholder in favor of the association, although to an amount not equal to the par value of the shares.[2]

§ 1548. Corporation Cannot Relieve Subscriber by Purchasing His Shares. — For a corporation to repurchase its shares at the price which the subscriber has paid for them is simply to distribute the trust fund of creditors, hereafter spoken of,[3] among those from whom it was originally collected. That this cannot be done as against the creditors, if it has any, is plain. That it cannot be done as against other shareholders is equally plain. In the absence of special circumstances, such as render allowable a compromise, it is safe to say that this cannot be done, as against other shareholders, in the absence of statutory authorization, without *unanimous consent*. For these reasons the general rule is that a corporation cannot purchase and hold its own shares.[4]

§ 1549. Illustration. — Thus, in *assumpsit* brought by a corporation against a stockholder to recover the amount due on his shares, it

[1] Interpretation of a by-law providing for a withdrawal on giving thirty days' notice "previous to the regular meeting of stockholders." Farnsworth *v.* Robbins, 36 Minn. 369; *s. c.* 31 N. W. Rep. 349.

[2] Laurel Run Building Assoc. *v.* Sperring, 106 Pa. St. 334. As to what dealings with his shares, by a member of a loan association, will operate to sever his connection with the association as a member, and clothe him with the character of a mere debtor to the association, see Bowker *v.* Mill River Asso., 7 Allen (Mass.), 100.

[3] *Post*, § 1569.

[4] *Post*, § 2054. It has been held that a corporation whose capital stock, as fixed and limited, has not been fully paid in, cannot *relieve a delinquent* stockholder from payment of assessment upon his stock by a purchase of the same, especially against the objection of another stockholder. Currier *v.* Lebanon Slate Co., 56 N. H. 262.

appeared that the board of directors had, by resolution, purchased for the company from this and other subscribers their shares, and, on behalf of the company, assumed the payment of their subscriptions; that the stock had been surrendered to the company, the subscriptions declared null and void, and released, and the secretary directed to cancel them. The court below charged the jury that if the company had assets sufficient to pay their debts, this cancellation of stock was valid and released the defendant. "From this," said Strong, J., in giving the judgment of the Supreme Court, "we entirely dissent. The directors of the company then in office were its agents, with limited powers, the extent of which the defendant was bound to know. Their duties were to conduct its affairs to the furtherance of the ends for which the company was created. They had no power to destroy it, to give away its funds, or to deprive it of any of its means to accomplish the full purpose for which it was chartered. The creditors were not the only persons who had interests and rights at stake. The stockholders who had paid their subscriptions or bought their stock, and the commonwealth, by whom the charter had been granted, were at least equally interested. The railroad was unfinished, and the commonwealth had a right to demand that all the resources, rights, and credits of the company should be devoted to its completion. An unfinished road was useless to the remaining stockholders, and it was a wrong to them to render their stock valueless by extinguishing that which was necessary and which should have been applied to the object for which the legislature gave the company its being. Directors of a railroad company are trustees for all the stockholders, and, in a very just sense, for the commonwealth. It is an abuse of their trust, wholly unauthorized, and at war with the design of the charter, to single out some of the stock subscribers and release them from their liability. No such authority in them has ever been recognized. It certainly was not in Lauman *v.* The Lebanon Valley R. Co.,[1] nor in any of the cases cited by the defendant in error. It is supported neither by authority nor reason. The instruction given to the jury was, therefore, entirely erroneous."[2]

§ 1550. Collusive Forfeitures. — It is supposed that all corporations existing in England and in this country possess, under their charters, governing statutes or constating instruments, the power to forfeit the shares of their members for the non-payment of installments due thereon which have been regu-

[1] 30 Pa. St. 42.

[2] Bedford R. Co. *v.* Bowser, 48 Pa. St. 37.

larly called for by the board of directors. The general rule is,[1] though there is some authority to the contrary,[2] that this is merely a *cumulative remedy* against shareholders, and that the existence of this right, without its exercise, does not deprive the

[1] *Post*, § 1784; Goshen Turnpike Co. *v.* Hurtin, 9 Johns. (N. Y.) 217; *s. c.* 6 Am. Dec. 273; Dutchess Cotton Man. Co. *v.* Davis, 14 Johns. (N. Y.) 238; *s. c.* 7 Am. Dec. 459; Beene *v.* Cahawba &c. R. Co., 3 Ala. 660; Selma &c. R. Co. *v.* Tipton, 5 Ala. 787; *s. c.* 39 Am. Dec. 344; Instone *v.* Frankfort Bridge Co., 2 Bibb (Ky.), 576; *s. c.* 5 Am. Dec. 638; Troy &c. R. Co. *v.* Kerr, 17 Barb. (N. Y.) 581; Rensselaer &c. Co. *v.* Barton, 16 N. Y. 459, note; Troy Turnpike Co. *v.* McChesney, 21 Wend. (N. Y.) 296; Herkimer Man. Co. *v.* Small, 21 Wend. (N. Y.) 273; Northern R. Co. *v.* Miller, 10 Barb. (N. Y.) 260; Mann *v.* Cooke, 20 Conn. 178; Freeman *v.* Winchester, 10 Smed. & M. (Miss.) 577; Stokes *v.* Lebanon &c. T. Co., 6 Humph. (Tenn.) 241; Gratz *v.* Redd, 4 B. Monr. (Ky.), 193; Mann *v.* Currie, 2 Barb. (N. Y.) 294; Hightower *v.* Thornton, 8 Ga. 502; *s. c.* 52 Am. Dec. 412; Sagory *v.* Dubois, 3 Sandf. Ch. (N. Y.) 466: McDonough *v.* Phelps, 15 How. Pr. (N. Y.) 372; Tar River Nav. Co. *v.* Neal, 3 Hawks (N. C.), 520; Highland Turnpike Co. *v.* McKean, 11 Johns. (N. Y.) 98; Hartford &c. R. Co. *v.* Kennedy, 12 Conn. 499.

[2] *Post*, § 1785; Worcester Turnpike Co. *v.* Willard, 5 Mass. 80; *s. c.* 4 Am. Dec. 39; Andover &c. T. Co. *v.* Gould, 6 Mass. 40; *s. c.* 4 Am. Dec. 80; Chester Glass Co. *v.* Dewey, 16 Mass. 94; *s. c.* 8 Am. Dec. 128; New Bedford &c. Turnpike Co. *v.* Adams, 8 Mass. 138; *s. c.* 5 Am. Dec. 81; Franklin Glass Co. *v.* Alexander, 2 N. H. 380; *s. c.* 9 Am. Dec. 92; New Hampshire Central R. Co. *v.* Johnson, 30 N. H. 390; *s. c.* 64 Am. Dec. 300. In this last case the Supreme Court of New Hampshire, after an examination of the authorities, concluded the true rule to be this: "Where a party makes an *express promise to pay* the assessments, he is answerable to the corporation upon such promise for all legal assessments, and may be compelled to its performance by action at law, before resorting to a sale of the shares. It is a personal undertaking, beyond the terms of the charter. Where, on the other hand, he only agrees to take a specified number of shares, without promising expressly to pay assessments, then resort must first be had to a sale of the shares to pay the assessments, before an action at law can be maintained. His agreement simply to take the shares is an agreement upon the faith of the charter, and by it alone is he to be governed, so far as his shares are to be affected. He takes them upon the conditions and law of the charter. They exist only by virtue of the charter, and are to be governed by the provisions therein contained." Where the contract of subscription contains an express promise to pay the assessments, and the conditions of the subscription have been performed, by all the authorities an action of *assumpsit*, or other like action, can be maintained in the first instance, without a proceeding to forfeit the shares, or a declaration of forfeiture, sale of them, or other equivalent act. South Bay Meadow Dam Co. *v.* Gray, 30 Me. 547; Smith *v.* Natchez Steamboat Co., 1 How. (Miss.) 479; Salem Mill-Dam Corp. *v.* Ropes, 6 Pick (Mass.) 23; Townsend *v.* Goewey, 19 Wend. (N. Y.) 424; *s. c.* 32 Am. Dec. 514; Dutchess Cotton Man. Co. *v.* Davis, 14

company of the power to maintain actions against its members for whatever is due from them on their contract of subscription. In such cases the corporation has an election between two remedies: it may either declare a forfeiture, or it may bring an action for the amount due. If it declares a forfeiture, and the charter, governing statute, or constating instrument does not otherwise provide, the relation between the shareholder and the corporation is thereby terminated,[1] and his contract of subscription is cancelled; and neither the corporation,[2] nor its creditors[3] can proceed against him for the remaining installments which would, but for the forfeiture, be due under his contract. The rule that a forfeiture of shares terminates a stockholder's liability to creditors has been carried so far, in New York, as to hold that after forfeiture a stockholder is not liable for debts contracted while he was a stockholder.[4] Under the English Joint-stock Companies Acts a similar rule obtains. After the shares of a member have been forfeited by the directors, in pursuance of the terms of the deed of settlement, he cannot, in the event of the insolvency of the company, be put upon the list of contributories,[5] unless insolvency supervenes within one year after forfeiture, in which case, by the terms of the Companies Act, 1862, he will be liable to contribute as a past member.[6] It is

Johns. (N. Y.) 238; *s. c.* 7 Am. Dec. 459; Worcester Turnpike Co. *v.* Willard, 5 Mass. 80; *s. c.* 4 Am. Dec. 39; Andover &c. T. Co. *v.* Gould, 6 Mass. 40; *s. c.* 4 Am. Dec. 80.

[1] As under the railway acts of Massachusetts. Rev. Stat. Mass. 1836, ch. 39, § 53; Gen. Stat. Mass. 1860, ch. 63, § 9. See Lexington &c. R. Co. *v.* Chandler, 13 Metc. (Mass.) 311; Troy &c. R. Co. *v.* Newton, 1 Gray (Mass.), 544.

[2] Small *v.* Herkimer Man Co., 2 N. Y. 330, overruling *s. c.* 21 Wend. (N. Y.) 273, and 2 Hill, 127; Andover &c. Turnpike Co. *v.* Gould, 6 Mass. 40; *s. c.* 4 Am. Dec. 80; Franklin Glass Co. *v.* White, 14 Mass. 286; Chester Glass Co. *v.* Dewey, 16 Mass. 94; *s. c.* 8 Am. Dec. 128; Ripley *v.* Sampson, 10 Pick. (Mass.) 371; Cutler *v.* Middlesex Factory, 14 Pick. (Mass.) 483; Mechanics' Foundry and Machine Co. *v.* Hall, 121 Mass. 272; Ashton *v.* Burbank, 2 Dill. (U. S.) 435; King's Case, L. R. 2 Ch. 714, 719, 731; Knights' Case, L. R. 2 Ch. 321.

[3] Allen *v.* Montgomery R. Co., 11 Ala. 450; Mills *v.* Stewart, 41 N. Y. 384 (Hunt, C. J., and Woodruff, J., dissenting); affirming *s. c.* 62 Barb. (N. Y.) 444; Macauly *v.* Robinson, 18 La. An. 619.

[4] Mills. *v.* Stewart, 41 N. Y. 384.

[5] Woollaston's Case, 4 De G. & J. 437; Beresford's Case, 2 Mac. & G. 197; Kelk's Case, L. R. 9 Eq. 107; Dawes' Case, L. R. 6 Eq. 232; Snell's Case, L. R. 5. Ch. 22.

[6] 25 and 26 Vict., ch. 89, § 38. See Thompson on Stockholders, § 97; Ramsay's Case, 3 Ch. Div. 388; Need-

obvious that the courts will not permit a power so necessary to the successful existence of corporations to be turned into an instrument for their destruction in the event of their becoming embarrassed. Moreover, when we recur to the doctrine that the capital stock of a corporation is a trust fund for the payment of its creditors,[1] it becomes clear that these courts will not permit this fund to be frittered away by collusive forfeitures of shares made by the directors while the company is in failing circumstances, and with the view of enabling the favored shareholders to escape from liability to the company's creditors. The American books abound in the strongest expressions of opinion upon the principle which governs this subject;[2] and the English courts unite with ours in holding that a *collusive* forfeiture of shares made by a corporation when in a condition of insolvency, or of impaired credit, will not release the shareholders in the event of the company being wound up.[3] Such arrangements, in the view of the American courts, are void as to creditors,[4] unless the creditors assent to them.[5]

ham's Case, L. R. 4 Eq. 135; Andrew's Case, L. R. 4 Eq. 458; *s. c.* L. R. 3 Ch. 161; Webb. *v.* Whiffen, L. R. 5 H. L. 711; Re Accidental &c. Ins. Corp., L. R. 5 Ch. 428; Brett's Case, L. R. 6 Ch. 800; Morris' Case, L. R. 7 Ch. 200; Weston's Case, L. R. 6 Eq. 17; Bridger's Case, L. R. 4 Ch. 266; Creyke's Case, L. R. 5 Ch. 63.

[1] *Post,* § 1569, *et seq.*

[2] Burke *v.* Smith, 16 Wall. (U. S.) 294; Upton *v.* Tribilcock, 91 U. S. 47; Bedford R. Co. *v.* Bowser, 48 Pa. St. 37; Mills *v.* Stewart, 41 N. Y. 386, 390; Slee *v.* Bloom, 19 Johns. (N. Y.) 456, 476; *s. c.* 10 Am. Dec. 273; Mann *v.* Cook, 20 Conn. 178.

[3] Richmond's Executor's Case, 4 Kay & J. 305, 325; Spackman's Case, 11 Jur. (N. S.) 207; *s. c. sub nom.* Spackman *v.* Evans, L. R. 3 H. L. 171; Stanhope's 2d Case, L. R. 1 Ch. 161, overruling (it seems) Brotherhood's Case, 4 De G. F. & J. 566. And see Stewart's Case, L. R. 1 Ch. 510; Gower's Case, L. R. 6 Eq. 77; Walter's 2d Case, 3 DeG. & Sm. 244. As to what amounts to a valid forfeiture or release of a shareholder under the English Companies Act, 1862, see, in addition to the foregoing, Snell's Case, L. R. 5 Ch. 22; Hall's Case, L. R. 5 Ch. 707. A clause in the deed of settlement of a joint-stock company to the effect that, in all cases not provided for by that or any supplemental deed of settlement, the directors may act in such a manner as to promote the interests and welfare of the retiring company has been held not to enable the directors to cancel the shares of a retiring director, so as to exempt him from future responsibility as a contributory. Stanhope's Case, 3 DeG. & Sm. 198.

[4] Slee *v.* Bloom, 19 Johns. 456, 476; *s. c.* 10 Am. Dec. 273; Mann *v.* Cook, 20 Conn. 178; Sagory *v.* Dubois, 3 Sandf. Ch. (N. Y.) 466; Upton *v.* Hansbrough, 3 Biss. (U. S.) 417, 427; Pickering *v.* Templeton, 2 Mo. App. 424.

[5] Slee *v.* Bloom, *supra.*

§ 1551. American Judicial Expressions on this Subject. — To vindicate this statement let us quote a few expressions from American cases: "If the judge had found that this forfeiture was made by collusion and fraud between the directors of the company and the respondent, his liability would not cease."[1] - - - - "Should they [the directors] forfeit it [stock] for the purpose of defrauding the corporation or any creditors, such forfeiture would for that reason be set aside."[2] - - - - "It must also be conceded that, if the company has, in fraud of its creditors, released subscribers to its stock from the payment of their subscriptions, the release is inoperative to protect those subscribers against claims of creditors. Under the law of the State [Indiana] all railroad companies are required to have a subscription to their capital stock not less than $1,000 for every mile of their proposed roads before they may exercise corporate powers. This requirement is intended as a protection to the public and to the creditors of the companies. And it is clear that the directors of a company organized under the law have no power to destroy it, to give away its funds, or deprive it of any means which it possesses to accomplish the purposes for which it was incorporated. The stock subscribed is the capital of the company, — its means for performing its duty to the commonwealth and to those who deal with it. Accordingly it has been settled by very numerous decisions that the directors of a company are incompetent to release an original subscriber to its capital stock, or to make any arrangement with him by which the company, its creditors, or the State shall lose any of the benefit of his subscription. Every such arrangement is regarded, in equity, not merely as *ultra vires*, but as a fraud upon the other stockholders, upon the public, and upon the creditors of the company."[3] - - - - "The capital stock of a moneyed corporation," said Mr. Justice Hunt,[4] "is a fund for the payment of its debts. It is a trust fund, of which the directors are the trustees. It is a trust fund to be managed for the benefit of its shareholders during its life, and for the benefit of its creditors in the event of its dissolution. This duty is a sacred one, and cannot be disregarded. Its violation will not be undertaken by any just-minded man, and will not be permitted by the courts. The idea that the capital of a corporation is a foot-ball to be thrown into the market for the purposes of speculation, that its value may be elevated or depressed to advance the interests of its managers, is a modern and wicked invention. Equally

[1] Murray J., in Mills *v.* Stewart, 41 N. Y. 386.

[2] Grover, J., in Mills *v.* Stewart 41 N. Y. 390.

[3] Mr. Justice Strong in Burke *v.* Smith, 16 Wall. (U. S.) 394.

[4] In Upton *v.* Tribilcock, 91 U. S. 47.

unsound is the opinion that the obligation of a subscriber to pay his subscription may be released or surrendered to him by the trustees of the company. This has been often attempted, but never successfully. The capital paid in, and promised to be paid in, is a fund which the trustees cannot squander or give away. They are bound to call in what is unpaid, and carefully to husband it when received."

§ 1552. A Distinctive Doctrine on this Subject in England. — The English cases on this subject will not, however, much aid the American judge or practitioner; because, as stated at the outset of this article,[1] the question is there viewed, for the most part, as a question involving the social rights of the members, and not the rights of the creditors, of the company. The central idea of the English cases seems to be that if one member is released by collusion, from his obligation to pay for his shares, the other members have so much more to pay. Such an act is *ultra vires* in the sense that the directors, as agents of the body of shareholders, have no power to do it; but it is not, as with us, *ultra vires* in a sense that the corporation itself has no power to do it, or to ratify the doing of it after it is done. The injury being in the view of the English courts, to the shareholders only, the act is held by those courts capable of being ratified by *all* the shareholders. Without going into those cases in detail which the author has done to some extent in another work,[2] the result of them may be thus restated:

1. A forfeiture by the directors of the shares of a member, not in accordance with the terms of the deed of settlement, is *ultra vires*, and voidable at the instance of a dissenting member.

2. But though thus voidable, if all the members had knowledge or sufficient means of knowledge of it, and acquiesced in it for a number of years, they will be deemed to have ratified it;

[1] *Ante*, § 1519.

[2] Thompson on Stockholders, § 196, *et seq.* The following cases were there examined: Spackman *v.* Evans, L. R. 3 H. L. 171; Evans *v.* Smallcombe, L. R. 3 H. L. 263; Holt's Case, 1 Sim. (N. S.) 389; Dixon's Case, L. R. 5 Ch. 79; Stanhope's First Case, 3 De G. & Sm. 198; Stanhope's Second Case, L. R. 1 Ch. 131; Belhaven's Case, 11 Jur. (N. S.) 572; *s. c.* 3 De G. J. & S. 41; Dawes' Case, L. R. 6 Eq. 232; Wright's Case, L. R. 7 Ch. 55; Martin's Case, 2 Hem & M. 669; Beresford's Case, 2 Mac. & G. 200; Re Phillips, 18 Beav. 629; Woollaston's Case, 4 De G. & J. 437; Kelk's Case, L. R. 9 Eq. 107; Bigg's Case, L. R. 1 Eq. 309; Moore *v.* Rawlins, 6 C. B. (N S.) 412; Stocken's Case, L. R. 3 Ch. 412.

and, in the event of the future insolvency of the company, the retiring member will not be put upon the list of contributories.

3. If, however, the forfeiture was *ultra vires*, and the proof does not raise a clear presumption of knowledge and acquiescence on the part of all the shareholders, in the event of subsequent insolvency, even after the lapse of several years, the retiring member will be put upon the list of contributories.

4. If the pretended forfeiture is attended with circumstances of collusion and fraudulent concealment, no lapse of time will prevent a restoration of the retiring member to his liability as a contributory.

5. If, however, the declaration of forfeiture, though not strictly regular, complies substantially with the deed of settlement, the retiring member will not be put upon the list of contributories.

§ 1553. But Bona Fide Compromises with Shareholders are Valid. — This doctrine does not extend so far as to annul a *bona fide* compromise of a question fairly in dispute, made between a corporation and one whom it claims to hold liable as a stockholder,[1] nor a compromise which becomes necessary to save the company from hopeless embarrassment.[2] This, of course, assumes that the compromise is made by the corporate body or agency which is vested with the power to make it; and that if it is made by the directors they have express power to that end, for it is doubtful whether such power will be implied. When, therefore, in an English case, the directors had power to compromise disputed claims, and there was a *bona fide* question as to whether a particular person had *ever been a shareholder*, and the directors released him on paying a certain amount, this release was sustained, and the person so released was held not liable as a contributory.[3] But it is necessary to the operation of

[1] Lord Belhaven's Case, 3 De G. J. & S. 41; *s. c.* 11 Jur. (N. S.) 572; Whitaker *v.* Grummond, 68 Mich. 249; *s. c.* 36 N. W. Rep. 62; Bath's Case, 8 Ch. Div. 334; Dixon's Case, L. R. 5 H. L. 606; reversing *s. c.* L. R. 5 Ch. 79. See also Wright's Case, L. R. 7 Ch. 55; reversing *s. c.* L. R. 12 Eq. 331; Fox's Case, L. R. 5 Eq. 118.

[2] New Albany *v.* Burke, 11 Wall. (U. S.) 96.

[3] Lord Belhaven's Case, and other English cases, *supra*. By the charter of a bank, certain persons were em-

this principle that there should be *something to compromise* — that there should be at least a *bona fide* dispute.[1] Accordingly, it was deemed no argument to support the validity of a collusive forfeiture that the deed of settlement authorized the board of directors to compromise disputed claims; nor that the other shareholders, having access to the books, might have known it, and must be deemed, after a lapse of considerable time, to have assented to it.[2]

§ 1554. **No Power to Cancel Valid Forfeitures.** — An English court has held that where a forfeiture of shares has been validly made by the directors, before the commencement of winding-up proceedings, the liquidators cannot, under section 131 of the Companies Act, 1862, cancel such forfeiture. Accordingly, where the directors of a company had forfeited the shares of D. for non-payment of calls, after the passing of a preliminary resolution to wind up, and before its confirmation, and the liquidators had subsequently agreed with D. to cancel the forfeiture, it was held that the forfeiture was valid, that the liquidators had no power to cancel it, and that D. could not be made a contributory.[3]

§ 1555. **Valid Cancellation on Invalid Grounds.** — A cancellation of shares by the directors, where the shareholder has

powered to subscribe for a certain amount of stock, in trust for the estate of an insolvent, in consideration of the transfer of certain property of the insolvent to the bank; afterwards in view of an ascertained deficiency in the property thus transferred, and of other circumstances connected therewith, the bank claimed a reduction in the amount of stock subscribed by the trustees. No transfer of the stock upon the books was permitted, and the bank refused to go into operation before an adjustment of the differences. Held, that a compromise entered into between the trustees and the assignees of the insolvent, and the persons acting on behalf of the bank by which a portion of the stock was surrendered in good faith, and which was, under the circumstances, reasonable, was valid, and that the trustees would be protected therein. Pierson *v.* Thompson, 1 Edw. (N. Y.) 212.

[1] Livingstone *v.* Temperance Colonization Soc., 17 Ont. App. 379; *s. c.* 31 Am. & Eng. Corp. Cas. 541; Spackman *v.* Evans, L. R. 3 H. L. 188, 231; Adams' Case, L. R. 13 Eq. 474; Phosphate of Lime Co. *v.* Green, L. R. 7 C. P. 43; Dixon's Case, L. R. 5 Ch. 79; *s. c.* reversed, but not on the doctrine above stated, L. R. 5 H. L. 606. Compare Wright's Case, L. R. 7 Ch. 55.

[2] Stanhope's Second Case, L. R. 1 Ch. 161.

[3] Dawes' Case, L. R. 6 Eq. 232.

valid grounds to claim cancellation, has been held good and effectual, although the shareholder claimed such cancellation on invalid grounds.[1] This, of course, assumes that the directors, in making the cancellation, are acting within their granted powers.

§ 1556. Municipal Subscription Discharged in Bonds: Repurchase of the Bonds at a Reduction.— A city subscribed $200,000 to the stock of a railroad company, and issued bonds for a part of the subscription, the remaining bonds to be issued upon the completion of the road to a certain point. The bonds thus issued were pledged by the company to creditors, to secure an indebtedness of less than one-half their nominal value. The validity of the issue of these bonds was denied by tax-payers, who filed bills to enjoin the levy of a tax to pay the interest thereon. The bonds being thus depreciated in market value, it became evident that if they were sold, as threatened by the creditors, they would not satisfy the debts for which they were pledged. The company became embarrassed, and, as they could never comply with the conditions necessary to a further issue of bonds by the city, the city entered into negotiations with the company for the purchase of the bonds which it had issued. These bonds, to the amount of $193,000, were purchased by the city from the company, the consideration being the payment of sundry indebtedness, and $36,000 to creditors who held a portion of the bonds as collateral security. This purchase was made September 8, 1857, and on January 29, 1868, the transaction was assailed as *ultra vires* on the part of the city authorities, by judgment creditors of the corporation, who filed their bill to set aside the arrangement. The Supreme Court of the United States decided that this arrangement was not a modification of the subscription previously made, or a bonus given for a release, but rather a purchase of the city debt, not beyond the power of the contracting parties, and not fraudulent as to creditors of the corporation, since the evidence was uncontradicted that it was deemed, at the time, an advantageous sale or arrangement for the company; and moreover, it was not made in secret, but, on the contrary, the ordinance of the city was published at the time. Besides, the laches of the complainants were fatal to their bill.[2]

§ 1557. Surrendering Stock in Land Companies in Exchange for Lands.— Where the charter of an incorporated

[1] Wright's Case, L. R. 7 Ch. 55; distinguishing Martin's Case, 2 Hem. & M. 669.

[2] New Albany *v.* Burke, 11 Wall. (U. S.) 96.

land company provides that each share of stock shall be received in payment of any land purchased of the company, and at prices fixed by the board of directors so as to secure a *pro rata* division of lands among the stockholders; and the by-laws provide that the stockholders shall have the right to exchange the stock for lands at rates fixed by the board of directors according to a schedule made by an executive committee; and the stock issued stipulates on its face that it is receivable for lands bought at prices fixed so as to secure a *pro rata* division of the lands or of their value among the stockholders,— after offer by a holder of a genuine certificate to surrender stock, and the designation and demand of title by him,— the corporation cannot affect the right of such stockholder by altering the value of the land on this schedule.[1]

[1] Franco-Texan Land Co. *v.* Bousslet, 70 Tex. 422; *s. c.* 7 S. W. Rep. 761.

CHAPTER XXVI.

PAYMENT OF SHARES.

ARTICLE I. IN GENERAL.

§ **1562. Must be Paid for at Their Full Value.**— Unless the governing statute otherwise provides, the general rule is that shares of corporate stock can only be issued by a corporation in the first instance *at their full value*.[1] Any scheme by which they are to be issued at a percentage of their par value is *ultra vires* and not enforceable.[2] This statement necessarily includes the proposition that neither the *directors*[3] nor, for

[1] Upton *v.* Tribilcock, 91 U. S. 45; Chouteau *v.* Dean, 7 Mo. App. 210; Kelhor *v.* Lademan, 11 Mo. App. 550; Williams *v.* Evans, 87 Ala. 725; *s. c.* 6 South. Rep. 702. Compare New Orleans R. Co. *v.* Frank, 39 La. An. 707. That an arrangement among stockholders to pay for their shares *in dividends* is, if valid, rescinded by giving a *stock note*, see McDowell *v.* Steel Works, 124 Ill. 401. That the rule of the text does not exclude *bona fide compromises* with stockholders, see Whitaker *v.* Grummond, 68 Mich. 249; *ante*, § 1553.

[2] Zelaya Min. Co. *v.* Meyer (City Ct. N. Y.), 28 N. Y. State Rep. 759; *s. c.* 8 N. Y. Supp. 487; Sturges *v.* Stetson, 1 Biss. (U. S.) 246; *s. c.* 10 Meyer Fed. Dec., § 149.

[3] Fisk *v.* Chicago &c. R. Co., 53 Barb. (N. Y.) 513; Sturges *v.* Stetson, 1 Biss. (U. S.) 246; *s. c.* 10 Meyer Fed. Dec., § 143.

stronger reasons, the *promoters* of a corporation have, in the absence of an enabling statute, the power to dispose of the shares of the corporation at less than their par value The principle supporting this rule has been thus clearly stated: "It is the settled American doctrine that every corporation holds its capital stock as a trust fund for the benefit of its creditors. The fund, however, does not exist until the stock is issued to shareholders. Up to that point there is a mere possibility or privilege of creation of stock. When a share is issued, if the price be paid in cash, so much is added to the working capital, thereby enhancing the creditor's security. If the price be not paid, the purchaser's indebtedness may be looked to for a like effect. In either case there is a tangible asset to which creditors may resort under the forms of law. The directors, who may be aptly styled the trustees, have no right to destroy the fund by giving away the stock, or which is the same thing, by disposing of it for an insignificant return. Its value in their hands, or rather the value of the creative privilege, is fixed by the charter. When they issue stock to an individual holder, there must be secured to the corporation, in some shape, an equivalent at so much per share, in accordance with the fundamental condition of the privilege."[1]

§ 1563. No Power in Directors to Fix Price of Stock or Issue it for Less than Face Value.—Let us enlarge on this subject a little. No power exists *in the directors* of a corporation to fix the price of a stock differently from the manner in which it is fixed by its charter or articles of association; or to sell it for less than its par value; or, especially, to make a contract to sell a part of it at less than its par value; and such an arrangement is a fraud on such of the stockholders as have paid in full for their shares. In commenting on a case presenting an arrangement of this kind, Mr. Justice McLean, at circuit, said: "There may be many instances where land is purchased for a depot, or for other purposes connected with the road, or where work has been done on the road or rolling stock furnished for it, and a subscription for stock may be given by the directors in pay-

[1] Chouteau *v.* Dean, 7 Mo. App. 210, 214.

ment. But whether land, labor, property or money be received in payment, the principle is the same. The directors may regulate the time and terms of payment, but they have no power over the price of each share. In declaring that the capital stock should be divided into shares of $50 each, the law was designed to give the same permanency to the limitation of the shares as to the limitation of the capital stock. A subscription procured of fifteen thousand shares, amounting to the sum of $750,000, with the understanding that it should be discharged on the payment of about one-third less, was a fraud upon the law and upon the stockholders. The term fraud is here used in no other sense than as an act done without the authority of law and against the provisions of the charter, and this epithet legally applies, however innocently the act may have been done by the directors. In regard to the price of the shares, the directors have no greater power over it than the commissioners had. They were both the instruments of the law, and were alike bound by its provisions. If power had been given to either to exercise a discretion so vital to the success of the scheme as to vary the price of shares, it would have destroyed all confidence in the enterprise. The plaintiff seemed to have been convinced of this, from the plan adopted to receive from the company the first bond for $750,000, to give to the act an appearance of fairness on the books of the company. It is essential to the success of any enterprise which involves the expenditure of money that the contributors should be placed upon an equal footing in regard to the money paid. In this case the plaintiff received in stock $228,333 more than he paid for. This was a fraud on the stockholders who had paid in full for their shares."[1] In reply to the argument that there was nothing in the charter which *prohibited* the directors from taking subscriptions of stock at less than $50.00 a share, the amount fixed by the charter, the learned justice said: "No such provision was necessary. The duties of the directors are plainly pointed out in the charter, and as their powers were wholly derived from that instrument, it was not necessary to prohibit them from doing that which the charter did not authorize them to do. The charter fixed the rates at which the shares should be

[1] Sturges *v.* Stetson, 1 Biss. (U. S.) 246; *s. c.* 10 Myer Fed. Dec., § 143.

subscribed. This is matter of law, and is no more subject to the discretion of the directors than it was to the discretion of the commissioners, who first received subscriptions.[1]

§ **1564. No Such Power in the Corporation Itself.** — The author states with great confidence the general principle to be, that the corporation itself has no power to dispose of its unissued shares in the first instance at less than their par value, unless empowered to do so by statute, either in express terms or by necessary implication.[2] This is simply another statement of the principle, elsewhere enlarged upon, that a corporation must in the first instance receive payment for its shares according to their face value, either in money or in money's worth.[3] This principle is deeply intrenched in public policy. It is necessary to prevent corporations from acquiring false credits and defrauding the public by a fictitious capitalization. It is to be regretted that the courts have ever admitted any exceptions to the rule. The breaking down of the principle under the sanction of judicial decisions has been productive of the greatest fraud and public injury. Such is the rule under the New York Manufacturing Act,[4] as declared in several cases, which hold that, where a corporation, governed by that act, issues its shares in exchange for property or labor, it can only take the property or labor at its fair value.[5] Such also is the rule under a provision of the constitution of Pennsylvania, prohibiting the issuing of corporate stocks or bonds except for money paid, labor done, or property

[1] Sturges *v.* Stetson, 1 Biss. (U. S.) 246; *s. c.* 10 Myer Fed. Dec., § 146.

[2] *Ante*, §§ 1553, 1562; *post*, § 1578.

[3] *Post*, § 1606.

[4] N. Y. Laws, 1848, ch. 40, § 2.

[5] Gamble *v.* Queens County Water Co., 123 N. Y. 91; *s. c.* 9 L. R. A. 527; 33 N. Y. St. Rep. 88; 8 Rail. & Corp. L. J. 484; 25 N. E. Rep. 201; reversing 52 Hun (N. Y.), 166; 5 N. Y. Supp. 124; 23 N. Y. St. Rep. 409. See also Schenck *v.* Andrews, 57 N. Y. 142; Boynton *v.* Andrews, 63 N. Y. 94; Lake Superior Iron Co. *v.* Drexel, 90 N. Y. 87. Under this statute a corporation which purchases property intending to pay therefor by issuing its stock and bonds, the former of which must be issued at par, will not be permitted to issue a much larger quantity of bonds taken at their actual value than is necessary to make up the difference between the par value of the stock offered and the purchase price of the property, the surplus bonds being rendered necessary by the fact that the actual value of the stock is much less than par. Gamble *v.* Queens County Water Co., *supra.*

actually received;[1] and under other similar provisions in State constitutions referred to.[2]

§ 1565. **Such Contracts not Aided in Equity.** — A contract of subscription to the shares of a corporation at less than their par value being *ultra vires* the directors and fraudulent in law, it will not be specifically enforced in equity while it remains executory; and it has been held that such a contract remains executory within this rule, where the subscriber gives his note for the shares, and instead of delivering the shares, the company deposits them with a trust company to be delivered on the payment of the note. The subscriber having afterwards discovered that the issue of the shares to him was fraudulent in law, and having refused to pay the note, and being proceeded against on the same in equity, by a bill for the *specific performance* of his contract of subscription, it was held that the court would not compel him to carry out the contract. In so holding, Mr. Justice McLean said: "If, on a full knowledge of the facts set up in his plea, the defendant takes the stock, he holds it subject to the right of the stockholders, prior to the subscription of the plaintiff, to have it reduced to the charter value of the shares. This would take from him nearly one third of his shares. The contract of the plaintiff is executory. He occupies a point which gives him the option to pay the money and carry out the contract, or to stand on the matters in bar, which he has set up in his plea. He has taken the latter ground, and it is for the court to say whether it is maintainable. The defendant seems to have done nothing to preclude him from the defense set up in his plea, which stands admitted by the demurrer, and which, in my judgment, is a sufficient answer to the action. The demurrer is overruled."[3] For stronger reasons it has been held that stock-

[1] A contract to furnish the labor and materials for the construction of a railroad at an expenditure not to exceed $200,000, the corporation, in consideration thereof, to issue to the contractor $300,000 of its capital stock as fully paid up and $300,000 of its first mortgage bonds, was held to contravene this constitutional provision; it appearing that the materials could be furnished and the road built for $180,000 cash. New Castle Northern R. Co. *v.* Simpson, 21 Fed. Rep. 533.

[2] *Post*, § 1691.

[3] Sturges *v.* Stetson, 1 Biss. (U. S.) 246; *s. c.* 10 Myer Fed. Dec. 149.

holders whose stock was issued as full paid, although nothing was in fact paid, and was given out and distributed under the pretense of paying for labor and services rendered, but in fact for the purchase of lottery privileges, in violation of the constitution of the State, who knew, or ought to have known, the tainted nature and consideration of the stock, can have no judicial aid to prevent the assets and property of the corporation from being carried out of and beyond the jurisdiction of the court.[1]

§ 1566. Effect of this Rule on the Liability of Shareholders to Creditors. — The effect of this rule is, that shareholders who purchase their shares *from the company* at less than their par value will, in the event of its insolvency, be liable to make good to its creditors the difference between its par value and the price at which it was issued to them.[2] They must then pay, for the benefit of the creditors, any balances on account of shares subscribed for or purchased by them, which have not been paid up in good faith, in money or in money's worth, as stated in a future section.[3] This principle is illustrated in a great varietv of situations, as we shall hereafter see.[4]

§ 1567. Statements of what the Law was and is aside from Recent Federal and State Holdings. — It is next proposed to consider what the English and American law on the subject of the payment of shares was and is aside from the Federal and State holdings hereafter considered.[5] And first, we find that it is conceded in those opinions — though the concession amounts to nothing in view of what was in fact held, — that unpaid subscriptions to the stock of a corporation constitute a trust fund for the benefit of its creditors, which may not be given away or disposed of by it, without consideration or fraudulently, to the prejudice of such creditors;[6] and that, as against subsequent creditors, a corporation cannot give away its stock or

[1] Le Warne *v.* Meyer, 38 Fed. Rep. 191; *s.c.* 6 Rail. & Corp. L. J. 52.

[2] Kehlor *v.* Lademan, 11 Mo. App. 550; Chouteau *v.* Dean, 7 Mo. App. 214.

[3] *Post,* § 1606. Hawley *v.* Upton, 102 U. S. 314; Thurston *v.* Duffy, 38 Hun (N. Y.), 327.

[4] *Post,* § 1606.

[5] *Post,* § 1665, *et seq.*

[6] Fogg *v.* Blair, 139 U. S. 118; *s. c.* 35 L. ed. 104; 11 Sup. Ct. Rep. 476.

distribute it among its shareholders, without receiving a fair equivalent therefor.[1] Recent State decisions not only *say* this, but they apply the rule to cases before them. American State courts have recently held that stockholders, to whom the stock of a corporation is transferred for a nominal consideration, are liable to its creditors for a further payment to the par value thereof, if it be necessary to satisfy the debts of the corporation; [2] that in an action against the stockholders of an insolvent corporation for debts of the corporation, it is only necessary, in order to make out a *prima facie* case, to establish the fact that the stockholders have not in good faith paid the par value of their stock; [3] that the acceptance of *new stock*, and a payment of 60 per cent. of its par value as payment therefor makes the other 40 per cent. assets of the corporation in case of its insolvency; [4] that where a contract of subscription for corporate stock provides that, on payment of 40 per cent. of the par value of the stock, the subscriber shall receive certificates of stock, a decree directing the issue of such certificates on payment of said 40 per cent. does not relieve the subscribers, as against creditors of the corporation, from liability for the remaining 60 per cent.; [5] that, as against creditors of a corporation, no contract made by the company is binding, which attempts to change a subscription into a purchase of full-paid stock, or to diminish the amount agreed to be paid by the stockholders, by showing that the company in taking the subscription was acting as the agent of an officer of the company, to whom the stock had been issued under a previous fraudulent contract of which the subscribers had no knowledge, to be by such officer transferred to the subscribers on payment by them of 40 per cent. of its par value.[6]

[1] Handley *v.* Stutz, 139 U. S. 417; *s. c.* 35 L. ed. 227; 11 Sup. Ct. Rep. 530; 9 Rail. & Corp. L. J. 362.

[2] Gogebic Inv. Co. *v.* Iron Chief Min. Co., 78 Wis. 427; *s. c.* 47 N. W. Rep. 726.

[3] *Ibid.*

[4] McAvity *v.* Lincoln Pulp &c. Co., 82 Me. 504; *s. c.* 20 Atl. 82.

[5] Bates *v.* Great Western Tel. Co., 134 Ill. 536; *s. c.* 25 N. E. Rep. 521; following Great Western Tel. Co. *v.* Gray, 122 Ill. 630; *s. c.* 14 N. E Rep. 214.

[6] *Ibid.* For a note on the power of courts to compel payment of subscriptions, and levy and payment of assessments, at instance of creditors of insolvent corporations, collecting English and American decisions, see 100 Am. Dec. 552, n.

§ 1568. The Leading Case, Upton v. Tribilcock, Considered. — The leading case in support of what the writer ventures to regard as still the American doctrine, will now be considered.[1] In this case the facts were thus stated by Mr. Justice Hunt: Two points are presented in this case. Upon the first point, the facts are as follows: The plaintiff, as assignee of the Great Western Insurance Company, a corporation organized under the statute of the State of Illinois, brought his action against the defendant, alleging that he was a stockholder of said corporation to the amount of $10,000; that twenty per cent. only had been paid upon his stock; alleging also the bankruptcy of the company, the appointment of the plaintiff as assignee, and the demand of the amount claimed, and seeking to recover the $8,000 remaining unpaid. The complaint averred that the defendant did verbally agree to become such stockholder, and, with intent to become such, did accept a certificate for the same, whereby he became bound to pay the full amount thereof, as follows: Five per cent. upon delivery of the certificates; five per cent. in three months; five per cent. in six months; five per cent. in nine months; and the residue whenever called for by the company, according to the charter of the company and the laws of the State of Illinois. The defense is that the subscription was obtained by the fraudulent representations of the agent of the company to the effect that the defendant would only be responsible for twenty per cent. of the subscription made by him; that afterwards he executed his promissory note for the twenty per cent., and secured the same by a mortgage of real estate; "and that thereupon (in the language of the answer), and pursuant to agreement, said subscription contract was surrendered and delivered up to defendant;" and also, in the language of the answer, "that said note was a full payment and discharge of all obligations and personal liabilities of all kinds whatsoever by reason of his contract so made and the relations created by the delivery to him of said certificate, and said note was received in full payment." In his third amended answer, the defendant avers that he did subscribe for stock on the conditions mentioned; that after that contract was made, and before a certificate was delivered to him, and before executing his note, an agreement was made with Overton on behalf of the company to the effect before stated; and thereupon he made and delivered the note and mortgage, which was received by Overton in full discharge and payment of the amount due on his said subscription. The evidence contained in the bill of exceptions leaves the case substantially as is averred in the pleadings. The defendant offered evidence tending to prove representations that twenty per cent. only was required to be

[1] Upton *v.* Tribilcock, 91 U. S. 45.

paid; that eighty per cent. was non-assessable, and created no personal liability; that the agent, Overton, exhibited a blank form of certificate with the word "non-assessable" printed across the face, "being a copy similar to that subsequently filled up and delivered to defendant by Overton." It appears that, before the defendant made his subscription, a copy of the charter and by-laws had been furnished to him by Overton; and that, in returns made by the company to the auditor of the State of Illinois of the amount of "unpaid subscribed capital for which the subscribers were liable," the amount of the defendant's note was included. The case standing in this position upon the pleadings and the evidence, the plaintiff requested the court to charge the jury as follows: 2d. That any contract between the company or its agents and the stockholders, limiting their liability as to unpaid installments of stock, is void as to creditors of the company, and as to the rights of the assignee who represents the creditors in this action. 3d. That if the jury find from the evidence that the defendant, J. D. Tribilcock, became a stockholder of the Great Western Insurance Company in the month of August, 1870, and that he continued to own and hold said stock until after the insolvency of the company in February, 1873, that any representations by any agent of the company at the time defendant became such stockholder as to the matter of his liability for eighty per cent. of the stock, or any indorsement on the stock of the word "non-assessable," are wholly immaterial, and constitute no defense to this action. This request was refused. It was held that in refusing so to charge the court erred. Mr. Justice Hunt gave the opinion of the court as follows: "It is hardly necessary to argue the proposition, that if the defendant became a holder of shares of the capital of this insurance company to the amount of $10,000, and had paid but twenty per cent. thereof, its creditors were entitled to require of him the payment of the eighty per cent. remaining unpaid. The acceptance and holding of a certificate of shares in an incorporation makes the holder liable to the responsibilities of a shareholder.[1] The capital stock of a moneyed corporation is a fund for the payment of its debts. It is a trust fund, of which the directors are the trustees. It is a trust to be managed for the benefit of its shareholders during its life, and for the benefit of its creditors in the event of its dissolution. This duty is a sacred one, and cannot be disregarded. Its violation will not be undertaken by any just-minded man, and will not be permitted by the courts. The idea that the capital of a corporation is a football to be thrown into the market for the purposes of speculation, that its value may be elevated or depressed to

[1] Citing Brigham *v.* Mead, 10 Allen (Mass.), 245; Buffalo &c. R. Co. *v.* Dudley, 14 N. Y. 336; Seymour *v.* Sturgess, 26 *Id.* 134.

advance the interests of its managers, is a modern and wicked invention. Equally unsound is the opinion that the obligation of a subscriber to pay his subscription may be released or surrendered to him by the trustees of the company. This has been often attempted, but never successfully. The capital paid in, and promised to be paid in, is a fund which the trustees cannot squander or give away. They are bound to call in what is unpaid, and carefully to husband it when received.[1] We are of the opinion that the alleged representation of the non-assessability of the stock held by him was quite immaterial.[2] Again, if full effect is given to the evidence of the defendant and to his claim in this respect, it shows this, and nothing more: He became a stockholder under a certificate signed by the president and secretary that he was entitled to one hundred shares of the stock of $100 each, payable five per cent. on receipt of the certificate; five per cent. in three months; five per cent. in six months; five per cent. in nine months from date; the time or manner of the payment of the residue not being specified. Upon the face of this certificate were stamped in red ink the figures '$100,' and in another place was stamped the word 'non-assessable.' This certificate he held until the insolvency of the company in 1873 was known to him. The legal effect of this instrument was to make the remaining eighty per cent. payable upon the demand of the company. We see no qualification of this result in the word non-assessable, assuming it to be incorporated into and to form a part of the contract. It is quite extravagant to allege that this word operates as a waiver of the obligation created by the acceptance and holding of a certificate to pay the amount due upon his shares. A promise to take shares of stock imports a promise to pay for them. The same effect results from an acceptance and holding of a certificate.[3] At the most, the legal effect of the word in question is a stipulation against liability to further taxation or assessment after the holder shall have fulfilled his contract to pay the one hundred per cent. in the manner and at the times indicated. We cannot give to it the consequence of destroying the legal effect of the certificate. Still, again, the representations relied upon as a defense, it will be noticed, were as to the legal effect of the defendant's subscription and certificate. It is alleged that the agent represented

[1] Citing Sawyer *v.* Hoag, 17 Wall. (U. S.) 610; Tuckerman *v.* Brown, 33 N. Y. 297; Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 380; Osgood *v.* Laytin, 3 Keyes, (N. Y.), 521; 37 How. Pr. (N. Y.) 63, aff'g 48 Barb. (N. Y.) 463; Gross Ill. Stat., p. 356, § 16.

[2] It was so held in Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 380.

[3] Citing Palmer *v.* Lawrence, 3 Sand., S. C. (N. Y.)161; Brigham *v.* Mead, 10 Allen (Mass.), 245.

that by the laws of the State of Illinois, and by the charter of this company, the defendant might become a subscriber to the amount of $10,000; and, by means of a certificate to be given to him like that exhibited, he would really be liable only to the extent of one-fifth of his said subscription, and that good lawyers had given their advice to this effect. There was here no error, mistake or misrepresentation of any fact. The defendant made the subscription he intended to make, and received the certificate he had stipulated for; and, as there is no evidence to the contrary, it is to be presumed the good lawyers advised as was stated; but, in law, the defendant incurred a larger liability than he anticipated.[1] He had received, several days before this time, a copy of the charter and by-laws of the company, and then had them in his possession. The twenty-fifth section of the by-laws was as follows: 'Every person who shall subscribe for $10,000 of stock, and pay twenty per cent. thereof, shall be constituted a director of this company, and shall continue such director so long as he shall retain of such stock an amount equal to $10,000; but such $10,000 shall not be reckoned in the election of other directors.' It was under this section and the succeeding one, authorizing the establishment of a branch in any place where such subscription was made, and by which the defendant became a director and might be president thereof, that the transaction took place. That the defendant did not read the charter and by-laws, if such were the fact, was his own fault. It will not do for a man to enter into a contract, and, when called upon to respond to its obligations, to say that he did not read it when he signed it, or did not know what it contained. If this were permitted, contracts would not be worth the paper on which they are written. But such is not the law. A contractor must stand by the words of his contract; and, if he will not read what he signs, he alone is responsible for his omission.[2] That a misrepresentation or misunderstanding of the law will not vitiate a contract, where there is no misunderstanding of the facts, is well settled. In Fish *v.* Clelland,[3] the principle is expressed in these words: 'A representation of what the law will or will not permit to be done is one on which the party to whom it is made has no right to rely; and if he does so it is his folly, and he cannot ask the law to relieve him from the consequences. The truth or falsehood of such a representation can be tested by ordinary vigilance and attention. It is an opinion in regard to

[1] Citing Leavitt *v.* Palmer, 3 N. Y. 19.

[2] Citing Jackson *v.* Croy, 12 Johns. (N. Y.) 427; Lies *v.* Stubbs, 6 Watts. (Pa.) 48; Farley *v.* Bryant, 32 Me. 474; Coffing *v.* Taylor, 16 Ill. 457; Slafyton *v.* Scott, 13 Ves. Jr. 427; Alvanley *v.* Kinnaird, 2 Mac. & G. 7; s. c. 29 Beav. 490.

[3] 33 Ill. 243.

the law, and is always understood as such.'[1] The law is presumed to be equally within the knowledge of all parties. That a stockholder may relieve himself from his liability by proof that he was misinformed as to the effect of his contract when he made it would be a disastrous doctrine. That a defendant, who could not by contract lawfully relieve himself from liability as a stockholder, can accomplish that result by proof that it was fraudulently represented to him that he could so relieve himself, would be strange indeed.[2] The rule, that a mistake of law does not avail, prevails in equity as well as at common law.[3] 'If ignorance of law was admitted as a ground of exemption, the court would be involved in questions which it were scarcely possible to solve, and which would render the administration of justice next to impossible; for in almost every case ignorance of law would be alleged, and the court would, for the purpose of determining this point, be often compelled to enter upon questions of fact insoluble and interminable.'[4] A statement that the insurance company had consulted with good lawyers, and that their opinion was as stated, should have been clear proof to the defendant that a representation of the law was a matter of opinion only."[5]

§ 1569. Distinction between the English and American Cases: The Capital Stock of a Corporation a Trust Fund for Creditors. —In considering the power of corporations with reference to their capital and shares, it is necessary to note a fundamental distinction between the English and American cases. In 1824 the fertile brain of Mr. Justice Story invented the doctrine that the capital stock of a corporation is a trust fund for the payment of its creditors; and that the creditors have an equitable lien or charge upon it superior to that of the stockholders.[6] This has become the settled doctrine of American courts.[7] If this doctrine means anything more than that the

[1] See Starr *v.* Bennett, 5 Hill (N. Y.), 303; Lewis *v.* Jones, 4 Barn. & Cress. 506; Rashdall *v.* Ford, L. R. 2 Eq. 750.

[2] Citing Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 380.

[3] Bank of U. S. *v.* Daniel, 12 Pet. (U. S.) 32; Hunt. *v.* Rousmaniere, 1 *Id.* 1; 8 Wheat. (U. S.) 174; Mellish *v.* Robertson, 25 Vt. 603; Leavitt *v.* Palmer, 3 Comst. (N. Y.) 19.

[4] Austin's Jur., vol. II., p. 172; Kerr. 397.

[5] Upton *v.* Tribilcock, 91 U. S. 45.

[6] Wood *v.* Dummer, 3 Mason (U. S.), 308.

[7] Story's Eq. Jur., § 1252; Wood *v.* Dummer, 3 Mason (U. S.), 308; Vose *v.* Grant, 15 Mass. 505; Spear *v.* Grant, 16 Mass. 15, 19; Baker *v.* Atlas Bank, 9 Metc. (Mass.) 192; Mumma *v.* Potomac Co., 8 Pet. (U. S.) 286; Curran *v.*

creditors of a corporation must be paid before its property can be distributed among its shareholders, then there would be no difference in this respect between the English and American decisions; for this is the rule which obtains in the winding-up of partnerships: the partnership creditors must be paid before the individual partners can divide the social assets among themselves. And, indeed, treating the shareholders as proprietors — and this is the only practical juridical conception of their status — this rule is nothing more than that which the law applies to every other debtor; he cannot keep and enjoy his property leaving his debts unpaid.

§ 1570. Continued: American Doctrine that Directors are Trustees for Creditors. — But the American cases which declare and apply the rule in question mean more than this. They mean that the directors and other corporate officers who have charge of the corporate assets are in a sense trustees of the creditors of the corporation; and some of these decisions have gone so far as to make them personally liable at the suit of creditors, for the mismanagement and waste of the corporate assets.[1]

§ 1571. Source of the American Doctrine that the Capital Stock of a Corporation is a Trust Fund, etc. — Although the

Arkansas, 15 How. (U. S.) 304; Tarbell *v.* Page, 24 Ill. 46; Ogilvie *v.* Knox Ins. Co., 22 How. (U. S.) 387; Payson *v.* Stoever, 2 Dill. (U. S.) 431; Sawyer *v.* Hoag, 17 Wall. (U. S.) 610; Burke *v.* Smith, 16 Wall. (U. S.) 390; New Albany *v.* Burke, 11 Wall. (U. S.) 96; Hightower *v.* Thornton, 8 Ga. 486; *s. c.* 52 Am. Dec. 412; Robinson *v.* Carey, 8 Ga. 530; Reid *v.* Eatonton Man. Co., 4 Ga. 102; *s. c.* 2 Am. Rep. 563; Slee *v.* Bloom, 19 Johns. (N. Y.) 456; *s. c.* 10 Am. Dec. 273; Briggs *v.* Penniman, 8 Cow. (N. Y.) 387, 395; *s. c.* 18 Am. Dec. 454; Mann *v.* Pentz, 3 N. Y. 422; Hurd *v.* Tallman, 60 Barb. (N. Y.) 272; Bank of St. Marys *v.* Powers, 25 Ala. 612; Carey *v.* Woodward, 53 Ala. 375; Smith *v.* Huckabee, 53 Ala. 195; Paschall *v.* Whitsett, 11 Ala. 472; Allen *v.* Montgomery R. Co., 11 Ala. 437; Bassett *v.* St. Albans Hotel Co., 47 Vt. 313; Adler *v.* Milwaukee Patent Brick Co., 13 Wis. 57; Miers *v.* Zanesville Co., 11 Ohio, 274; *s. c.* 13 Ohio, 197; Henry *v.* Vermillion Co., 17 Ohio, 187; Moss *v.* Burroughs, 1 Woods (U. S.), 467; Payne *v.* Bullard, 23 Miss. 88, 90; *s. c.* 55 Am. Dec. 74; Tinkham *v.* Borst, 31 Barb. (N. Y.) 407.

[1] Schley *v.* Dixon, 24 Ga. 273; Maisch *v.* Saving Fund, 5 Phila. (Pa.) 30; Leffman *v.* Flanigan, 5 Phila. (Pa.) 155. See also Bank of St. Marys *v.* St. John, 25 Ala. 566; Gratz *v.* Redd, 4 B. Mon. (Ky.) 178, 191, 196; Lexington &c. R. Co. *v.* Bridges, 7 B. Mon. (Ky.) 556.

cases cited by Mr. Justice Story in the leading case on this subject[1] would not so indicate, it may be conjectured that the American doctrine on this subject was adapted from the English rule that the property of a charitable corporation is a trust fund, and that the court of chancery has jurisdiction over its custodians as trustees.[2]

§ 1572. This Doctrine not Found in Modern English Books.— We do not find in the modern English books any distinct trace of such a doctrine. On the contrary, the doctrine that the directors of a corporation are trustees for its creditors has been distinctly denied in a late case in the English Court of Appeal.[3] Moreover, the primary object of the English winding-

[1] Wood *v.* Dummer, 3 Mason (U. S.), 308.

[2] See Green's Brice's Ultra Vires, 2d ed. 50, and American notes.

[3] Poole's Case, 9 Ch. Div. 322, 328. In this case three directors of a company, who had not been called upon to pay anything upon their shares, made themselves liable upon their personal guaranty for money advanced to the company by a bank. The company got into difficulties, and the bank recovered a judgment against the directors on their guaranty. The directors then passed a resolution that, in order to reduce the balance due to the bank in question, "it is recommended that the directors do pay up the amount of their shares," etc., "as contemplated in the company's prospectus." The amounts thus due were then paid in and were immediately paid over to the banking company. Two days afterwards the company was ordered to be wound up. Vice-Chancellor Bacon held that this transaction could not stand. It was the duty of the directors to retain the assets of the company and to distribute them according to law, and not to give any one creditor a preference over another; and any contrivance by which, in contemplation of bankruptcy or winding up, the assets were intercepted in favor of one creditor to the exclusion of another was unlawful and invalid under the Company's Act, 1862, § 164. But this decision was reversed in the court of Appeal (Jessel, M. R., James and Bramwell, L. JJ.). In giving the judgment of this court, Jessel, M. R., said: "The vice-chancellor decided the question upon this ground, that the directors were trustees of all their powers. So, no doubt, they were. But it is further said that they exercised their powers in breach of trust and for their own benefit, and, therefore, that the act which they did was nugatory. But it appears to me that the question is, for whom were they trustees? It does not appear that the vice-chancellor considered this point; but it makes all the difference whether they were trustees for the persons who were injured by what had been done in this case, namely, the other creditors of the company. It has always been held that the directors are trustees for the shareholders, that is, for the company. They are the managing partners of the company, and if they abuse their powers, which they

up act of 1848 was declared by Sir John Romilly, himself the author of that act, not to satisfy creditors, but to produce equality among shareholders.[1] This seems to have been universally conceded in subsequent cases; and even under the Companies Act of 1862, which was framed with the view of winding up companies for the benefit of creditors as well as for that of shareholders, it is obvious from expressions of the judges in winding-up proceedings that the social rights of shareholders are looked to rather than the rights of creditors.[2]

§ 1573. Further Distinction between the English and American Cases—In America the Stockholder a Trustee for Creditors. — The capital stock of a corporation, which is subject to the operation of this rule, consists of all the stock *which the members have subscribed.*[3] This is deemed to consist of three funds: 1. Money which has been subscribed and paid in. 2. Money thus subscribed but not paid in.[4] 3. Money thus subscribed, but afterwards improperly divided among the members, leaving the debts of the corporation unpaid.[5] Stated in another

hold in trust for the company, to the damage of the company, for their own benefit, they are liable to make good the breach of trust to their *cestui que trust* like any other trustees. But the directors are not trustees for the creditors of the company. The creditors have certain rights against a company and its members, but they have no greater rights against the directors than against any other members of the company. They have only those statutory rights against the members which are given them in the winding up."

[1] Re Phillips, 18 Beavan, 629.

[2] Spackman *v.* Evans, L. R. 3 H. L. 171.

[3] Adler *v.* Milwaukee Patent Brick Co., 13 Wis. 57; Hightower *v.* Thornton, 8 Ga. 486; *s. c.* 52 Am. Dec. 412; Briggs *v.* Penniman, 8 Cow. (N. Y.) 387; Allen *v.* Montgomery R. Co., 11 Ala. 437; Slee *v.* Bloom, 19 Johns. (N. Y.) 456; *s. c.* 10 Am. Dec. 273; Wood *v.* Dummer, 3 Mason (U. S.), 308; Mann *v.* Pentz, 3 N. Y. 422; Payne *v.* Bullard, 23 Miss. 90; *s. c.* 55 Am. Dec. 74.

[4] Slee *v.* Bloom, 19 Johns. (N. Y.) 459; *s. c.* 10 Am. Dec. 273; Briggs *v.* Penniman, 8 Cow. (N. Y.) 386; *s. c.* 18 Am. Dec. 454; Ward *v.* Griswoldville Man'fg Co., 16 Conn. 597; Mann *v.* Pentz, 3 N. Y. 422; Allen *v.* Montgomery R. Co., 11 Ala. 437; Spear *v.* Grant, 16 Mass. 9; Hightower *v.* Thornton, 8 Ga. 486; *s. c.* 52 Am. Dec. 412; Bassett *v.* St. Albans Hotel Co., 47 Vt. 314; Henry *v.* Vermillion &c. R. Co., 17 Ohio, 187; Payne *v.* Bullard 23 Miss. 90; *s. c.* 55 Am. Dec. 74; Sanger *v.* Upton, 91 U. S. 60.

[5] Wood *v.* Dummer, 3 Mason (U. S.), 308; Curran *v.* Arkansas, 15 How. (U. S.) 304; Reid *v.* Eatonton Man. Co., 40 Ga. 98, 104; *s. c.* 2 Am. Rep. 563; Lewis *v.* Robertson, 13 Smed. & M. (Miss.) 558.

way, the capital stock of a corporation, in the eye of an American court of equity, is the stake or pledge upon which the company obtains credit. If any member has not paid his share of it into the common treasury, he is deemed to hold so much of a fund in his pocket, upon which the creditors of the concern have an equitable charge or lien, and a court of equity will lay hold of him and compel him to surrender up this fund for the benefit of such creditors.[1] It is a necessary part of this doctrine that shareholders who have not paid in all that they have subscribed of the capital stock of the company, are, as to so much as they still retain, constructive trustees for the creditors of the corporation. But some of the American courts have gone further and held that they are express trustees for such creditors, and that this trust is of that fiduciary character which prevents the running of the *statute of limitations* in favor of the stockholders and against the creditors, until the corporation itself dissolves or ceases business.[2] We have met with no English case which ascribes this character to shareholders, although we do not know that it would be inconsistent with the doctrines of the English courts of equity to do so.

§ 1574. Further Distinction between the Doctrine of the English and American Cases: Power of English Companies to make their own Regulations Touching their Capital and Stock. — A further distinction between the English and American cases is one which extends into most of the questions discussed in this work, but which is of peculiar force with reference to the subject of this chapter. The constitutions of American companies, in their leading features, are established by the legislature, and they are allowed to make by-laws for the regulation of minor

[1] Adler *v.* Milwaukee Patent Brick Co., 13 Wis. 60.

[2] Curry *v.* Woodward, 53 Ala. 371, 376. The Supreme Court of Georgia declares it to be "a direct trust, purely technical, not cognizable at law, but falling within the proper, peculiar and exclusive jurisdiction of equity, and consequently one not subject to the presumption of payment or satisfaction or waiver." Hightower *v.* Thornton, 8 Ga. 486, 502; *s. c.* 52 Am. Dec. 412. In the High Court of Errors and Appeals of Mississippi it was said to be "a continuing, subsisting trust and confidence, to which the statute of limitations has no application." Payne *v.* Bullard, 23 Miss. 88; *s. c.* 55 Am. Dec. 74. See also Allibone *v.* Hager, 46 Pa. St. 48, where the question arose under a statute.

matters; but the English Companies Act, 1862, leaves to the members of companies, with very little restriction, the power to establish their own constitutions; and, as the amount of capital stock which the company shall have, the manner of its distribution, and the liability of its shareholders to the company, are matters for the most part of private concern, this is peculiarly true of such matters. For this reason, in nearly all the English cases which will be cited in this article, the questions decided arose upon a consideration of the terms of the private constating instruments of particular companies, called articles of association and deeds of settlement. Nevertheless, they may be appealed to in support of a number of rules which are applicable in this country; and, so far as they are capable of such applications, they have been considered.

§ 1575. A Corporation cannot Convert this Trust Fund into an Ordinary Debt. — From this view of the character of the capital stock of corporations, which, as already stated, includes that part which has been *subscribed* for but *not paid in*, it follows that it is incompetent for the corporation to enter into any engagement which will have the effect of converting this trust fund into an ordinary debt. In a leading case on this subject an insurance company was organized under a charter which authorized it to commence business on a capital stock of $100,000, with $10,000 paid in, and the remainder secured by notes, or mortgages of real estate, or otherwise. Sawyer subscribed for fifty shares, of the par value of $100 each, and gave his check for the full amount, namely, $5,000. He took the check of the company for $4,250, being the amount of his subscription less the fifteen per cent. required of each stockholder to be paid in cash, and he gave his note for the amount of the latter check, with good collateral security for its payment, with interest at seven per cent. per annum. Sawyer and the company, by its officers, agreed to call this latter transaction a loan, and the check of Sawyer payment in full of his stock. On the books of the company, and in all other respects as between themselves, it was treated as payment of the subscription and a loan of money. Mr. Justice Miller, delivering the opinion of the court, held that this could not be done, saying: "In the case before us the

assignee of the bankrupt, in the interest of the creditors, has a right to inquire into this conventional payment of his stock by one of the shareholders of the company; and on that inquiry we are of opinion that, as to these creditors, there was no valid payment of his stock by the appellant. We do not base this upon the ground that no money actually passed between the parties. It would have been just the same if, agreeing beforehand to turn the stock debt into a loan, the appellant had brought the money with him, paid it, taken a receipt for it, and carried it away with him. This would be precisely the equivalent of the exchange of checks between the parties. It is the intent and purpose of the transaction which forbids it to be treated as valid payment. It is the change of the character of the debt from one of a stock subscription unpaid to that of a loan of money. The debt ceases by this operation, if effectual, to be the trust fund to which creditors can look, and becomes ordinary assets, with which the directors may deal as they choose. And this was precisely what was designed by the parties. It divested the claim against the stockholder of its character of a trust fund, and enabled both him and the directors to deal with it freed from that charge. There are three or four of these cases now before us in which precisely the same thing was done by other insurance companies organized in Chicago, and we have no doubt it was done by this company in regard to all their stockholders. It was, therefore, a regular system of operations to the injury of the creditor, beneficial alone to the stockholder and the corporation. We do not believe we characterize it too strongly when we say that it was a fraud upon the public who were expected to deal with them. The result of it was that the capital stock of the company was neither paid up in actual money, nor did it exist in the form of deferred installments properly secured."[1]

§ 1576. Nor Divide it Among their Members, Leaving Debts Unpaid. — For the same reasons, it is not competent to a corporation to divide its capital stock among its stockholders leaving debts unpaid; but every stockholder so receiving a portion of the capital stock is liable in equity to contribute *pro*

[1] Sawyer *v.* Hoag, 17 Wall. (U. S.) 610; *s. c.* 10 Myer Fed. Dec., § 153; 1 Cent. L. J. 43.

rata to the discharge of the corporate debts out of the fund in his hands.[1] But this principle does not extend so far as to require stockholders to surrender, for the benefit of creditors, *bona fide dividends* of profits declared and distributed at a time when the company was solvent and prosperous.[2] The reasons which support this rule are that the profits and accretions springing from the use of the capital stock of a corporation form no part of the capital stock itself, and hence no part of the stake on which the company acquires credit.[3] Persons doing business know that these profits, although they may be accumulated in the form of what is called a surplus fund, and used by the company in its business, are always subject to be distributed in dividends, at the will of the board of directors. Whilst, therefore, the existence of a large surplus, subject to executions on judgments against the corporation, may, in the opinion of persons dealing with it, render its continued solvency more probable, yet this constitutes no reason why such a fund, fairly divided among the shareholders, leaving the company able to meet its existing obligations, should, in the event of a subsequent insolvency of the corporation, be pursued by its creditors. But a division of such assets at a time when the corporation was insolvent, or in contemplation of insolvency, would partake of the nature of a conveyance in fraud of creditors, and a creditor's bill would lie to reach and subject them to execution. Such a bill would also be sustained on the ground that strict trusts are at all times open to the examination of a court of equity, and that such a court will never refuse to bring before it an unfaithful trustee, whom it will compel to discover the fund impressed with the trust and to account for its misappropriation and misman-

[1] Story's Eq. Jur., § 1252; Wood *v.* Dummer, 3 Mason (U. S.), 308; Voss *v.* Grant, 15 Mass. 517, 522; Spear *v.* Grant, 16 Mass. 15; Curran *v.* Arkansas, 15 How. (U. S.) 304; Reid *v.* Eatonton Man. Co., 40 Ga. 98, 104; *s. c.* 2 Am. Rep. 563; Bank of St. Marys *v.* St. John, 25 Ala. 566.

[2] Reid *v.* Eatonton Co., 40 Ga. 98; *s. c.* 2 Am. Rep. 563.

[3] *Post*, § 2152. State *v.* Morristown Fire Assn., 23 N. J. L. 195; Barry *v.* Merchants' Exchange Co., 1 Sandf. Ch. (N. Y.) 303; Hightower *v.* Thornton, 8 Ga. 486, 500; *s. c.* 52 Am. Dec. 412; per Lumpkin, J. "They [the stockholders] have the benefit of all the *profits* made by the establishment, and cannot take any portion of the fund [capital stock] until all other claims on it are extinguished." Story, J., in Wood *v.* Dummer, 3 Mason (U. S.), 311.

agement.[1] For when a corporation becomes insolvent, all its assets — not alone its capital stock — become impressed with the character of a trust fund for the security of its creditors.

§ 1577. Nor Release their Members from Paying for their Shares. — In the view of most American courts, whoever subscribes to an unconditional agreement to take shares becomes liable to pay for them, subject to the conditions named in the subscription paper, and to those imposed by the charter or by the general law.[2] But where a subscription is, on its face, made *conditional* on the doing of a certain act by the corporation, unless the condition is performed there is no contract, and the subscriber cannot be held to the liabilities of a shareholder.[3]

[1] Bank of St. Marys *v.* St. John, 25 Ala. 609.

[2] *Ante*, § 1512, *et seq.* Hartford &c. R. Co. *v.* Kennedy, 12 Conn. 499; Sagory *v.* Dubois, 3 Sandf. Ch. (N. Y.) 466; Union Turnpike Co. *v.* Jenkins, 1 Caines (N. Y.), 381; Goshen Turnpike Co. *v.* Hurtin, 9 Johns. (N. Y.) 217; *s. c.* 6 Am. Dec. 273; Duchess Cotton Man. Co. *v.* Davis, 14 Johns. (N. Y.) 238; *s. c.* 7 Am. Dec. 459; Spear *v.* Crawford, 14 Wend. (N. Y.) 20; *s. c.* 28 Am. Dec. 513; Highland Turnpike Co. *v.* McKean, 11 Johns. (N. Y.) 98; Strong *v.* Wheaton, 38 Barb. (N. Y.) 616; Burr *v.* Wilcox, 22 N. Y. 557; Pickering *v.* Templeton, 2 Mo. App. 424; Beene *v.* Cahawba &c. R. Co., 3 Ala. 660; Upton *v.* Tribilcock, 91 U. S. 47; Brigham *v.* Mead, 10 Allen (Mass.), 245; Buffalo &c. R. Co. *v.* Dudley, 14 N. Y. 336; Seymour *v.* Sturgess, 26 N. Y. 134; Dayton *v.* Borst, 31 N. Y. 435; Rensellaer &c. Co. *v.* Barton, 16 N. Y. 457, n; Lake Ontario &c. Co. *v.* Mason, 16 N. Y. 451; Hartford &c. R. Co. *v.* Croswell, 5 Hill (N. Y.), 383; *s. c.* 40 Am. Dec. 354; Northern R. Co. *v.* Miller, 10 Barb. (N. Y.) 260; Kennebec &c. R. Co. *v.* Palmer, 34 Me. 366; Connecticut &c. R. Co. *v.* Bailey, 24 Vt. 465; *s. c.* 58 Am. Dec. 181; Foy *v.* Lexington R. Co., 2 Metc. (Ky.) 314; Klein *v.* Alton &c. R. Co., 13 Ill. 514; Barrett *v.* Alton &c. R. Co., 13 Ill 504.

[3] *Ante*, § 1332, *et seq.* Fort Miller &c. R. Co. *v.* Payne, 17 Barb. (N. Y.) 579; Chase *v.* Sycamore &c. R. Co., 38 Ill. 215; Wear *v.* Jacksonville &c. R. Co., 24 Ill. 593; Burke *v.* Smith, 16 Wall. (U. S.) 390; Pitchford *v.* Davis, 5 Mee. & W. 2; Fox *v.* Clifton, 6 Bing. 776; Robert's Case, 3 De G. & S. 205; Wood's Case, 3 De G. & J. 85; Buffalo &c. R. Co. *v.* Pottle, 23 Barb. (N. Y.) 21; Macedon &c. Plank-road Co. *v.* Lapham, 18 Barb. (N. Y.) 312; Burlington &c. R. Co. *v.* Boestler, 15 Iowa, 555; Henderson *v.* Railroad Co., 17 Texas, 560; *s. c.* 67 Am. Dec. 675; Penobscot &c. R. Co. *v.* Dummer, 40 Me. 172; *s. c.* 63 Am. Dec. 654; Penobscot &c. R. Co. *v.* Dunn, 39 Me. 587; Philadelphia &c. R. Co. *v.* Hickman, 28 Pa. St. 318; Evansville &c. R. Co. *v.* Shearer, 10 Ind. 244; Jewett *v.* Lawrenceburg &c. R. Co., 10 Ind. 539; Martin *v.* Pensacola &c. R. Co., 8 Fla. 370; *s. c.* 73 Am. Dec. 713; New Albany R. Co. *v.* McCormick, 10 Ind. 499; *s. c.* 71 Am. Dec. 337; Junction R. Co. *v.* Reeve, 15 Ind. 236; Milwaukee R. Co. *v.* Field, 12 Wis. 340;

He is entitled to *notice* of the performance of the condition before an action can be sustained against him on his contract,[1] unless the act be one that carries notice of itself.[2] But he may subsequently *waive* the condition and bind himself absolutely,[3] as by executing a promissory note for the amount for which he has subscribed,[4] or by paying the first installment, voting the whole stock at an election, and acting as an officer of the corporation.[5] The English courts hold that if the application for shares is conditional there is no contract, although the allotment is unconditional.[6] Nor is it necessary, within the meaning of this rule, that the expression of the condition should be in the same letter with the application for the shares, provided they reach the directors together.[7]

§ 1578. **Nor Agree that Unpaid Shares Shall be Deemed Fully Paid up.**—Subject to the limitations just expressed, it is incompetent for a corporation to issue shares as fully paid up, when in fact they have not been paid up. It may, as hereafter stated,[8] in the absence of fraud, agree that certain *property*, of a kind which it may lawfully take, shall be deemed full payment for shares, and this agreement will be binding upon itself, and in the absence of fraud, cannot be impeached by its creditor. In such a case, if the property delivered is a fair equivalent for the par value of the shares, and such as the company might lawfully take, the shares delivered in payment are, in point of fact, "fully paid up shares."[9] Here there would be no sense in requiring the vendor of the property to hand over to the company so much cash for the shares, and the company then to hand

Dayton &c. R. Co. *v.* Hatch, 1 Disney (Oh.), 84; Roberts *v.* Mobile & Ohio R. Co., 32 Miss. 373.

[1] Banet *v.* Alton &c. R. Co., 13 Ill. 504; Spangler *v.* Indiana &c. R. Co., 21 Ill. 276; Wear *v.* Jacksonville &c. R. Co., 24 Ill. 593; Chase *v.* Sycamore &c. R. Co., 38 Ill. 218.

[2] Chase *v.* Sycamore &c. R. Co., 38 Ill. 218.

[3] Dayton &c. R. Co. *v.* Hatch, 1 Disney (Oh.), 84.

[4] O'Donald *v.* Evansville &c. R. Co. 14 Ind. 259. Compare Miller *v.* White, 7 Blackf. (Ind.) 491.

[5] Dayton &c. R. Co. *v.* Hatch, 1 Disney (Oh.) 84.

[6] Shackleford's Case, L. R. 1 Ch. 567; Roger's Case, L. R. 3 Ch. 637.

[7] Roger's Case, L. R. 3 Ch. 637.

[8] *Post*, § 1604.

[9] Phelan *v.* Hazard, 5 Dill. (U. S.) 45; *s. c.* 6 Cent. L. J. 109; Re Baglan Stall Colliery Co., L. R. 5 Ch. 346; Schroder's Case, L. R. 11 Eq. 131.

it back to the vendor in payment for his property; and such a useless form is not required.[1] On the contrary, a credit by a company to a shareholder on account of a conveyance to the company of specific property, such as they were authorized to purchase, is deemed a payment in cash within the terms of a statute which provides that "every share in any company shall be deemed and taken to have been issued, and to be held subject to the payment of the whole amount thereof *in cash*, unless the same shall have been otherwise determined by a contract duly made in writing and filed with the registrar of joint-stock companies, before the issue of such shares."[2] So, shares subscribed for by A. may be paid for by a credit given at the request of B. upon a judgment recovered against the company by B.[3] But there is no principle which can sanction the power of a corporation to give away its shares, even where the question is viewed, as in England, not as a question of public concern, but as a mere question of social right among the proprietors.[4]

§ 1579. Further of Agreements that Shares shall be Deemed "Fully Paid up." — Among the many devices which have been resorted to by the members of corporations to escape the liability assumed by their contracts of subscription, perhaps the most common, and at the same time the most shallow and ineffective, has been for the members to agree among themselves that their shares shall be deemed to be "fully paid up," when in fact they have not been so paid.[5] Even in England, where these questions are generally considered solely with reference to the rights of the shareholders *inter se*,[6] such agreements, as between the original parties and their privies, have been declared invalid by the courts.[7] And even the Supreme Court of the United States concedes the principle, while refusing to apply it,

[1] Fothergill's Case, L. R. 8 Ch. 270.

[2] Coates' Case, L. R. 17 Eq. 169; Spargo's Case, L. R. 8 Ch. 407.

[3] Ferrao's Case, L. R. 9 Ch. 355.

[4] Daniell's Case, 1 De G. & J. 372; *s. c.* 22. Beav. 43; 23 Beav. 568; Dent's Case, L. R. 15 Eq. 407.

[5] Pickering *v.* Templeton, 2 Mo. App. 424, 429; A. Wright Co. *v.* Steinkemeyer, 6 Mo. App. 574; Deadwood First Nat. Bank *v.* Gustin-Minerva, &c. Co., 42 Minn. 327; *s. c.* 6 L. R. A. 676; 44 N. W. Rep. 198.

[6] *Ante*, § 1572; *post*, § 1592.

[7] Daniell's Case, 1 De G. & J. 372; *s. c.* 22 Beav. 43; 23 Beav. 568; Dent's Case, L. R. 15 Eq. 407.

that a contract between the subscribers to stock and the corporation, that the stock shall be treated as fully paid and non-assessable, or otherwise limiting their liability therefor, is void as against creditors.[1] And we may conclude with great confidence, that the general doctrine is, except in so far as it has been shaken in California,[2] Minnesota,[3] New York,[4] and in the Supreme Court of the United States,[5] that any agreement, secret or otherwise, between the corporation and its shareholders that its shares shall not be paid in full, though possibly good as between the corporation and shareholders, is *void as to creditors* of the corporation, in the event of its insolvency.[6]

§ 1580. Such Agreements Frauds on other Shareholders. — The directors of a corporation being trustees, primarily for the shareholders and subsequently for the creditors while the corporation continues a going concern, and thereafter primarily for the creditors and subsequently for the shareholders, — it is obvious that they have no power, without the consent of the beneficiaries in the trust, to give away the trust fund. They cannot, therefore, release a subscriber from his obligation to pay for his shares according to the contract of subscription without

[1] Handley *v.* Stutz, 139 U. S. 417; *s. c.* 35 L. ed. 227; 11 Sup. Ct. Rep. 530; 9 Rail. & Corp. L. J. 362.

[2] Stein *v.* Howard, 65 Cal. 616.

[3] Hospes *v.* Northwestern Man. &c. Co., 48 Minn. 174; *s. c.* 50 N. W. Rep. 1117; 36 Am. & Eng. Corp. Cas. 206.

[4] *Post*, § 1587.

[5] *Post*, § 1586, and § 1665, *et seq.*

[6] Scovill *v.* Thayer, 105 U. S. 143; Union Mutual Life Ins. Co. *v.* Frear Stone Man. Co., 97 Ill. 537; *s. c.* 37 Am. Rep. 129; Rider *v.* Morrison, 54 Md. 429; Jewell *v.* Rock River Paper Co., 101 Ill. 57; Wetherbee *v.* Baker, 35 N. J. Eq. 501; Crawford *v.* Rohrer, 59 Md. 599; Upton *v.* Tribilcock, 91 U. S. 45; Chubb *v.* Upton, 95 U. S. 665; Upton *v.* Hansbrough, 3 Biss. (U. S.) 417; Sawyer *v.* Hoag, 17 Wall. (U. S.) 610; Slee *v.* Bloom, 19 Johns. (N. Y.) 456; *s. c.* 10 Am. Dec. 273; Sagory *v.* Dubois, 3 Sandf. Ch. (N. Y.) 466, 499; Osgood *v.* King, 42 Ia. 478; Burnham *v.* Northwestern Ins. Co., 36 Ia. 632; Jackson *v.* Traer, 64 Ia. 469; *s. c.* 52 Am. Rep. 449; Mann *v.* Cooke, 20 Conn. 178; Pickering *v.* Templeton, 2 Mo. App. 424; Skrainka *v.* Allen, 7 Mo. App. 534; *s. c.* aff'd 76 Mo. 385; Chouteau *v.* Dean, 7 Mo. App. 210; Gill *v.* Balis, 72 Mo. 424; Melvin *v.* Lamar Ins. Co. 80 Ill. 446; *s. c.* 22 Am. Rep. 199; Blodgett *v.* Morrill, 20 Vt. 509; White Mountain R. Co. *v.* Eastman, 34 N. H. 124; Robinson *v.* Pittsburg &c. R. Co., 32 Pa. St. 334; *s. c.* 72 Am. Dec. 792; Graff *v.* Pittsburg &c. R. Co., 31 Pa. St. 489; Stanhope's Case, L. R. 1 Ch. 161; Zirkel *v.* Joliet Opera House Co., 79 Ill. 334. See also Mangles *v.* Grand Collier Dock Co., 10 Simons, 519; Preston *v.* Grand Collier Dock Co., 11 *Id.* 327.

the consent of all the shareholders so as to make the release a good one as against them, nor, without the consent of all the creditors, so as to make it good as against them. Moreover, the sound rule is believed to be that they cannot do this with the consent of the shareholders and of the creditors, so as to bind future shareholders and future creditors who become such without knowing that the stake on which the corporation does business has been thus frittered away and reduced. It is evidently in this sense that releases of subscribers and sham payments of their subscriptions are said to be "frauds on the law."[1] All secret agreements releasing particular subscribers from the obligation of payment, or otherwise attempting to reduce the obligation of their contract are, then, in the first instance void as frauds upon *other subscribers*.[2] This is especially so as to future subscribers who may be presumed to subscribe on the faith and under the persuasion, so to speak, of the subscription thus released.[3]

§ 1581. **Not Necessary that Other Shareholders should Prove that they were Actually Misled.** — The rule approaches the grade of public policy, when it is held that it is not necessary that shareholders seeking in equity to have such contracts avoided, should, in order to succeed, furnish distinct proof that they were in fact misled by the conditional character of the subscription. It seems that it will be *presumed* that they and other shareholders in their situations were so misled.[4]

§ 1582. **What Agreements Avoided by the Rule.** — All agreements between the subscriber and the corporation,[5] its officers,[6] agents,[7] promoters,[8] or members,[9] by which payment

[1] *Ante*, § 1309. Or "in fraud of the statute:" Port Whitby R. Co. *v.* Jones, 31 Up. Can. Q. B. 170.

[2] White Mountain Co. *v.* Eastman, 34 N. H. 124.

[3] Melvin *v.* Lamar Ins. Co., 80 Ill. 446; *s. c.* 22 Am. Rep. 199.

[4] Melvin *v.* Lamar Ins. Co. 80 Ill. 446, 461; *s. c.* 22 Am. Rep. 199, 209.

[5] Thompson *v.* Reno Savings Bank, 19 Nev. 103; Skrainka *v.* Allen, 7 Mo. App. 434; *s. c.* 76 Mo. 384; Lee *v.* Imbrie, 13 Or. 510; Great West. Tel. Co. *v.* Gray, 122 Ill. 630; *s. c.* 19 Am. & Eng. Corp. Cas. 260; 14 N. E. Rep. 214; 11 West. Rep. 739; 27 Am. L. Reg. (N. S.) 160.

[6] Osgood *v.* King, 42 Iowa, 478.

[7] Jewell *v.* Rock River Paper Co., 101 Ill. 57.

[8] Joy *v.* Manion, 28 Mo. App. 55; Ollesheimer *v.* Thompson, Man. Co., 44 Mo. App. 172.

[9] A stockholder cannot defend against creditors, after the corporation has become insolvent, on the ground

is dispensed with in whole or in part; or by which colorable or nominal payments are accepted,[1] are void, — as where shares are voted to a director as a *bonus*, under a contract between him and the corporation that they shall not be assessable; [2] or where a Louisiana corporation, organized for the nominal purpose of developing public improvements in Mexico, but really to carry on a lottery, issued its shares as paid up without any payment being made thereon; [3] or where corporate stock which has been subscribed for, but not taken up, is transferred to the company, and by it sold as "treasury stock" to third persons for less than its par value.[4] On the same principle it has been held that, where the stock of a corporation is not subscribed for up to the minimum amount of capital fixed by the charter, and none of it is paid in, if the corporators organize, elect themselves as officers, proceed to business, and contract debts up to and beyond the nominal capital, having paid in nothing whatever, they commit a legal fraud by so doing, and are liable to creditors to make good the minimum capital, together with interest thereon, should this be necessary to discharge the corporate debts.[5]

§ 1583. Effect of Recital in Certificate that the Stock is "Full Paid." — It has been said that "if any *presumption of fact* arises from the face of a stock certificate in customary form, it is that the stock certified to belongs to the holder, is his without incumbrance — in other words, is fully paid for." [6] But if we lay out of view the question of the rights of a *bona fide* purchaser who takes the shares on the faith of a recital in the certificate that they are fully paid up, it is clear that a mere recital

that there was a verbal understanding between himself and some members of the company that he should be relieved of his stock after certain difficulties were settled in the company. Topeka Manuf. Co. *v.* Hale, 39 Kan. 23.

[1] Crawford *v.* Rohrer, 59 Md. 599.

[2] Richardson's Executor *v.* Green, 133 U. S. 30; *s. c. sub. nom.*, Washburn *v.* Green, 33 L. ed. 516; 10 Sup. Ct. Rep. 280.

[3] LeWarne *v.* Meyer, 38 Fed. Rep. 191.

[4] Alling *v.* Wenzel, 133 Ill. 264, 273; *s. c. sub nom.* Alling *v.* Ward, 24 N. E. Rep. 551; 8 Rail. & Corp. L. J. 124.

[5] Burns *v.* Beck &c. Hardware Co., 83 Ga. 471; *s. c.* 10 S. E. Rep. 121; Compare Hill *v.* Silvey, 81 Ga. 500; *s. c.* 8 S. W. Rep. 808; 3 L. R. A. 150; 39 Alb. L. J. 316.

[6] Johnson *v.* Lullman, 15 Mo. App. 55, 57; *s. c.* affirmed, 88 Mo. 567.

in a stock certificate that the shares are "full paid" cannot make them full paid as against creditors of the corporation. It is merely the statement by the corporation, in the form of a paper issued to the stockholder, of a fact which both of them know not to be true.[1]

§ 1584. Substituting the Paid-up Shares of Another Member — Payment by other Members. — Applying the foregoing doctrine, it has been held that a member of a corporation who has subscribed for a given number of shares of its capital stock, cannot procure shares which have been purchased and paid for by another member and have them substituted for his; and this for the obvious reason that the effect of such an arrangement is to release him entirely from paying for the shares for which he has subscribed.[2] But, of course, one member may pay for another; and upon a subscription by several persons for stock in a corporation, payment may be made in the property or money of one so as to satisfy the liability of the others.[3]

§ 1585. Stock Paid up and Money Loaned back to Stockholder. — The capital stock of a corporation being a trust fund for the security of creditors,[4] this trust cannot be defeated by a *simulated payment* of the stock subscription, nor by anything short of an actual payment in good faith.[5] The assets of a company cannot be applied to return to the shareholders what they have or ought to have paid upon their shares.[6] An arrangement by which the stock is nominally paid and the money immediately taken back as a loan to the stockholder is a device to change the debt from a debt impressed with the character of a trust to an ordinary loan, and is not a valid payment as against creditors of the corporation, though it may be good as between the company and the stockholder.[7] But a division among the shareholders of money which it has not engaged to apply in keeping up the

[1] A. Wight Co. *v.* Steinkemeyer, 6 Mo. App. 474.

[2] Marshall Foundry Co. *v.* Killian, 99 N. C. 501; *s. c.* 6 Am. St. Rep. 539, 545.

[3] Vail *v.* Phillips, 14 N. J. Law Journal, 45.

[4] *Ante*, § 1569.

[5] Upton *v.* Tribilcock, 91 U. S. 45.

[6] Lee *v.* Neuchatel Asphalte Co., 41 Ch. Div. 1; *s. c.* 6 Rail. & Corp. L. J. 266.

[7] Sawyer *v.* Hoag, 17 Wall. (U. S.) 610; *s. c.* 1 Cent. L. J. 43.

nominal amount of their share capital has been held not a return and division of capital among the shareholders so as to render the *dividend ultra vires*.[1]

§ **1586. Stock Issued to Bondholders as a Bonus.**—If the principle that the corporation cannot give away its capital stock, or cannot issue its shares at less than their par value, is of any validity, it must follow that if a corporation issues to its bondholders its stock with, say forty per cent. credited thereon as paid, they will be liable to the corporation, in the event of the corporation becoming insolvent, to the extent of the unpaid forty per cent.[2] It is to be regretted that we must quote the New York Court of Appeals to the contrary in a case arising upon such a transaction, ignoring a well settled and oft repeated principle,[3] founded in the plainest reason and justice.[4] The court boldly denies the proposition that the unissued shares of a corporation are a trust fund in the hands of its directors in the sense that they cannot give them away, if that is the understanding of the parties, and holds that creditors of the corporation cannot compel the donee of the shares to pay for them. The decision, though apparently by a unanimous court, is worthy of very little respect. It is creditable to the Supreme Court of New York that its decision at general term was otherwise. The attempt to distinguish the Missouri decision elsewhere quoted, as "standing on its special circumstances," was very weak. As elsewhere seen,[5] the Supreme Court of the United States has let itself down to the same doctrine, in holding that where a company cannot sell its bonds at par, without giving with them an equal amount of its increased stock, and the par value of the bonds was no more than equal to the actual value of both stock and bonds, the purchaser cannot be compelled by creditors of the corporation to pay the par value of

[1] Lee *v.* Neuchatel Asphalte Co., 41 Ch. Div. 1; *s. c.* 6 Rail. & Corp. L. J. 266. Compare Parton *v.* New Orleans &c. Co., 3 La. An. 19; *post*, § 2951.

[2] Skrainka *v.* Allen, 7 Mo. App. 434; *s. c.* 76 Mo. 384.

[3] *Post*, § 2951.

[4] Christenson *v.* Eno, 106 N. Y. 97; *s. c.* 60 Am. Rep. 429; 19 Am. & Eng. Corp. Cas. 269; 12 N. E. Rep. 648; 8 Cent. 70; 8 N. Y. St. Rep. 682. See also Christenson *v.* Quintard (Sup. Ct.) 29 N. Y. State Rep. 61; *s. c.* 8 N. Y. Supp. 400.

[5] *Post*, § 1665, *et seq.*

the stock.[1] The Supreme Court of Tennessee, on the other hand, maintains the sound rule of public policy, by holding that, under a statute governing manufacturing corporations, by which they are prohibited from lending money to their shareholders, a scheme of organization, by which each subscriber to the capital stock of the company is to receive interest-bearing bonds of the company, secured by a mortgage upon the company's assets, to an extent equal to the par value of his subscription,— is void, even as between the company and its shareholders, while it remains solvent. The company may repudiate such an arrangement at pleasure, and a dissenting shareholder cannot have relief in equity, either to be discharged of his contract of subscription or to have the agreement of the company to issue the interest-bearing bonds specifically enforced. The reason is that this arrangement, in substance and effect, is an arrangement whereby the franchise granted to manufacturing corporations is to be secured, while at the same time the public are to be deprived of that security which by law they are entitled to have and on which the grant of the franchise depends. Such an arrangement would throw all the risks and hazards of the business upon the public who should deal with the corporation, while the corporators would reap all the possible gains and would be secured against loss in the event that the enterprise should prove unprofitable.[2]

[1] Handley *v.* Stutz, 139 U. S. 417; *s. c.* 35 L. ed. 227; 11 Sup. Ct. Rep. 530; 9 Rail. & Corp. L. J. 362 (reversing *s. c.* 41 Fed. Rep. 531).

[2] Morrow *v.* Nashville &c. Co., 87 Tenn. 262; *s. c.* 10 Am. St. Rep. 658; 3 L. R. 837; 10 S. W. Rep. 495. The mere suggestion of the fact that the effect of such a scheme is to make the shareholders *secured creditors* while the public, who deal with the company and give it credit, occupy the position of *general creditors*, and hence of deferred creditors, if the scheme is valid, proves its invalidity, at least so far as creditors are concerned; and as between the corporation and the stockholders, it is rightfully declared invalid on general grounds of public policy which are fully set out in the opinion of the court by Mr. Justice Lurton. The court distinguish Sawyer *v.* Hoag, 17 Wall. (U. S.) 610, and Scoville *v.* Thayer, 105 U. S. 143. Compare Paducah &c. R. Co. *v.* Parks, 86 Tenn. 560; Gamble *v.* Queens County Water Co., 123 N. Y. 91; *s. c.* 9 L. R. A. 527; 31 Am. & Eng. Corp. Cas. 313; 25 Abb. N. Cas. 410; 33 N. Y. St. Rep. 88; 8 Rail. & Corp. L. J. 484; 25 N. E. Rep. 201 (Rev'g *s. c.* 52 Hun, 166; 23 N. Y. St. Rep. 409; 5 N. Y. Supp. 124).

§ 1587. Contrary View that Receiver of Shares Issued as a Gratuity not Liable to Creditors. — Contrary to the doctrine of the Supreme Court of Missouri[1] and to all sound principle, it has been held by the Court of Appeals of New York upon the same state of facts and upon the same transaction, that where a corporation assumes to distribute, as a mere gratuity or bonus to its shareholders, shares as paid up, on which nothing has in fact been paid, the receivers of such shares are not, in the event of the insolvency of the corporation, liable to creditors to the extent of the amount which remains unpaid on the shares. The court say: "We can see no ground upon which he can be made to respond to the creditors of the company as upon an unpaid subscription. Assuming that the transaction as to the company was *ultra vires*, or that it could not give away its shares, the transaction in that view was simply a nullity, and Eno got nothing as against any one entitled to question the transaction. But it did not convert him into a debtor of the company for the forty per cent, He entered into no contract to pay it. He had received nothing on account of the twenty-five shares, and it is not claimed that the charter in terms imposes the liability claimed. The unissued shares of a corporation are not assets. When issued they represent a proportionate interest in the shareholder in the corporate property — an interest, however, subordinate to the claims of creditors. There are unquestioned public evils growing out of the creation and multiplication of shares of stock in corporations not based upon corporate property. The remedy is with the legislature. But the liability of a shareholder to pay for stock does not arise out of his relation, but depends upon his contract, express or implied, or upon some statute; and in the absence of either of these grounds of liability, we do not perceive how a person to whom shares have been issued as a gratuity has, by accepting them, committed any wrong upon creditors, or made himself liable to pay the nominal face of the shares as upon a subscription or contract." [2]

[1] Stated in the next section.

[2] Christenson *v.* Eno, 106 N. Y. 97, 101; *s. c.* 60 Am. Rep. 431, 432. Followed in Christenson *v.* Quintard, 29 N. Y. St. Rep. 61; *s. c.* 8 N. Y. Supp. 400. Compare Re Western Canada Oil Co , 1 Ch. Div. 115.

§ 1588. Bonds Issued to Shareholders as a Bonus, or to Indemnify them against Assessments.— Let us turn this transaction around, and suppose that, instead of the corporation issuing its stock to its bondholders as a bonus, it issues its bonds to its stockholders as a bonus; or what is substantially the same thing, issues its stock to them, in violation of the statute law, at less than par, and then issues its bonds to them to indemnify them against assessments upon the stock. From whichever side we view such a transaction, we are simply looking at different sides of the same species of fraud. In either case the corporation issues its potential stock at less than par, and gives away (or what is the same thing agrees not to collect) a portion of that which equity has stamped with the quality of a trust fund for its creditors. On sound principles neither of these arrangements can stand. Accordingly where, by an arrangement between a corporation and persons who were invited to become its sharehalders, the latter became such with the understanding that calls upon their stock were not to exceed forty per cent. but afterwards the exigencies of the corporation were such that calls were made in excess of that amount, at which time, to compensate the shareholders for this excess in the calls, the corporation issued mortgage bonds to them,— it was held that they were liable to creditors in respect of these bonds as they would have been if the calls had been made upon their shares and had not been paid. The arrangement by which the company called in money in respect of the shares, and at the same time made itself liable to pay back the same to the shareholders, was not deemed in substance and effect a release of the shareholders in respect of the sum so called. In giving judgment upon this state of facts (for a fuller statement of which the reader is referred to the opinion itself), the court, speaking through Lewis, P. J., say: " This transaction stands on a similar footing with the one first described. The liabilities of a corporation constitute a counter-weight against its assets. Whatever consideration should restrain a member from appropriating or diminishing its assets, must have the same influence against his increasing its liabilities. It is true that the stock was here paid for to the extent of the calls, and was not appropriated as a gratuity. But it was a part of the same transaction that

the liabilities of the company were correspondingly increased without a valuable consideration. An increase of liability is no less antagonistic to the hopes of the general creditor than is a diminution of assets. The trust relation sustained by the corporator to the creditor embraces as well the duty of avoiding certain exhaustive indebtedness, as it does that of husbanding the resources of the corporation by other means. A different rule would deny to members the privilege of enriching themselves at the expense of the corporation by entries on one side of the ledger, and would yet permit them to accomplish the same result by entries on the opposite page."[1]

§ 1589. Bonds of Corporation Issued to Stockholders as a Bonus. — But there was difficulty in holding that if a corporation issue to its stockholders, as a mere bonus or gratuity, its bonds maturing at a future day, and *pays nothing upon them*, but becomes insolvent, the transaction does not create a liability in respect of the bonds, on the part of the stockholders to the creditors of the corporation. The stockholder cannot be compelled to account to the creditors for any sum which he may have realized from the sale of the bonds, because the quest of the creditor is affected by the fatal difficulty that the stockholder has received nothing from the corporation except its promise to pay, which has never been performed. He has drawn nothing from the funds of the company on account of the bonds, unless it may be a sum represented by interest which has been paid upon the coupons, and beyond this the creditors have not been prejudiced by the transaction. The case presented is therefore not the case of following the assets of a corporation wrongfully transferred. The stockholder has received none of the funds or assets of the company which otherwise would have been available to its creditors. The loss on the bonds falls, not on the creditors of the corporation, because there has been no diminution of the corporate funds by reason of issuing them, but upon the misguided outsiders who have purchased them relying on the credit of the corporation.[2]

[1] Skrainka *v.* Allen, 7 Mo. App. 434, 440; *s. c.* affirmed on this point, 76 Mo. 384. See also Habershon's Case, L. R. 5 Eq. 289; Hay's Case, L. R. 10 Ch. App. 600.

[2] Christenson *v.* Eno, 106 N. Y. 97; *s. c.* 60 Am. Rep. 429.

§ 1590. Such an Arrangement when Valid as between the Company and the Stockholders. — In such a case, where the books of the company, and the directors as well as the stockholders, concur in saying that the stock is fully paid, it would, as between the stockholder and the company, *all the other stockholders consenting*, be regarded as fully paid, though not so as to creditors.[1] So, in Illinois, a stockholder who becomes such for the mere purpose of enabling the corporation to obtain a certificate of organization, and under an agreement with the other subscribers that he shall not be required to pay assessments, and shall not be liable on the stock, but that he will hold it *as trustee* and they will help him dispose of it, — cannot be assessed thereon except to pay corporate debts. He is under no liability in favor of the other stockholders.[2] But it seems that such a subscriber might well be held to the letter of his contract of subscription; for the courts ought not to aid such a fraud upon the law. So, in a leading case in the Supreme Court of the United States this principle was fully conceded. "The charter," said Mr. Justice Miller, "under which the company was organized, authorized it to commence business upon a capital stock of $100,000, with ten thousand paid in, and the remainder secured by notes with mortgages on real estate or otherwise. The transaction by which the appellant professes to have paid up his stock subscription is, shortly, this: He gave to the company his check for the full amount of his subscription, namely, $5,000. He took the check of the company for $4,250, being the amount of his subscription less the fifteen per cent. required of each stockholder to be paid in cash, and he gave his note for the amount of the latter check, with good collateral security for its payment, with interest at seven per cent. per annum. The appellant and the company, by its officers, agreed to call this latter transaction a loan, and the check of the appellant payment in full of his stock; and on the books of the company, and in all other respects as between themselves, it was treated as payment of the subscription and a loan of money. It is agreed that at this time the current rate of interest in Chicago was greater

[1] Skrainka *v.* Allen, 76 Mo. 384, 391–392, per Hough, C. J.

[2] Winston *v.* Dorsett Pipe &c. Co., 129 Ill. 64; *s. c. sub. nom.* Winston *v.* Brooks, 21 N. E. Rep. 514; 4 L. R. A. 507; 6 Rail. R. & Corp. L. J. 150.

than seven per cent., and it is not stated as a fact whether these checks were ever presented and paid at any bank, or that any money was actually paid or received by either party in the transaction. It must, therefore, be treated as an agreement between the corporation, by its officers, on the one part, and the appellant, as a subscriber to the stock of the company, on the other part, to convert the debt which the latter owed the company for his stock into a debt for the loan of money, thereby extinguishing the stock debt. Undoubtedly this transaction, if nothing unfair was intended, was one which the parties could do effectually as far as they alone were concerned. Two private persons could thus change the nature of the indebtedness of one to the other if it was found to be mutually convenient to do so. And in any controversy which might or could grow out of the matter between the insurance company and the appellant we are not prepared to say that the company, as a corporate body, could deny that the stock was paid in full."[1] It may, however, be doubted, whether such an arrangement would be good, even as against the corporation, without unanimous consent, or a subsequent ratification by all the stockholders.[2]

§ 1591. May be Valid as between the Members Personally. — As already seen,[3] there is nothing wrongful or contrary to any principle of public policy in an agreement made by some of the shareholders of the corporation by which they obligate themselves to take the shares of another off his hands and refund his money within a fixed time, provided it is done in good faith, although other subscribers are not informed of it; and therefore such an agreement may be enforced between the immediate parties to it;[4] though of course it could not be enforced against the corporation or its creditors.[5] It is assumed with confidence that it would be held void as between the immediate parties to it, if it could be shown that it was a corrupt arrangement entered into for the purpose of enabling the promoters to hold out the

[1] Sawyer *v.* Hoag, 17 Wall. (U. S.) 610; *s. c.* 10 Myer Fed. Dec., § 150.

[2] *Ante* § 1516, 1580.

[3] *Ante*, § 1515

[4] Morgan *v.* Struthers, 131 U. S. 246, *s. c.* 9 S. Ct. Rep. 726; 33 L. ed. 132.

[5] Williams *v.* Benet, 34 South Car. 112; *s. c.* 13 S. E. Rep. 97.

party thus induced to subscribe as a decoy to influence the subscriptions of others.[1]

§ 1592. In England the Company is Estopped by its Contract, from Demanding Payment, but may have Damages for the Fraud. — More recently the doctrine has sprung up in England that, upon the winding up of a company, the rights of the creditors can only be enforced through the official liquidator, against the shareholders, *in the right of the company.* If, then, the company is estopped by its own contract from asserting that the shares are not fully paid up, the official liquidator representing creditors will be in the same situation. It resulted that where the members of the company, in organizing it, agreed that the shares were to be deemed fully paid, or paid to a given extent, and the company was so registered, the official liquidator was not permitted to show that the shares were not paid as so represented, for the purpose of charging the shareholders as contributories. This conclusion was made to rest upon the ground that, the shareholders having made one contract for themselves, the courts cannot make another for them.[2] It is a *breach of trust* for the directors to issue such shares, and the person receiving them with knowledge is liable as a participator in the wrong; but he cannot be capriciously punished by being required to do what he has not agreed to do, — pay for the shares in full. It seems that the company or its representative can proceed against him to recover the shares, or whatever damage it has sustained through the perpetration of the wrong. The effect of such an act is not to make the share-taker liable *ex contractu* for the nominal value of the shares, but to make him liable *ex delicto* for their real value.[3]

§ 1593. Authority to Sell Bonds no Authority for Selling Stock at Less than Par. — In a case previously cited, it was argued that, from the authority given to the directors to sell "notes, bonds, scrip, and certificates for the payment of money or property,

[1] *Ante*, § 1515.

[2] Waterhouse *v.* Jamieson, L. R. 2 H. L. (Sc.) 29; Ex parte Currie, 32 L. J. (Ch.) 57; *s. c.* 3 De G. J. & S. 367; 7 L. T. (N. S.) 486; Carling's Case, 1 Ch. Div. 115; Burkinshaw *v.* Nicholls, 26 W. R. 821, House of Lords, 1878.

[3] Carling's Case, 1 Ch. Div. 115. Compare Dent's Case, L. R. 15 Eq. 407.

which the company had previously received as donations, or in payment of subscriptions to the capital stock," above or below par, they had power to dispose of the shares of the company's stock to subscribers at less than $50.00 a share, the amount fixed by the charter. In overruling this contention, Mr. Justice McLean said: "It appears to me the provision authorizes an inference in conflict with the one drawn. If bonds, or other instruments for the payment of money, be transferred at less than their face, with legal interest on the entire sum, in payment for the money loaned, it would be usurious; and this was the reason for the above provision. Without it, the sale of the bonds, etc., would have been illegal. A certificate of stock was issued to the plaintiff for fifteen thousand shares, amounting to the sum of $750,000, of which only $521,677 were paid, which was less for the shares than the price fixed by the charter by $228,303. This sum, distributed among the shareholders at the time of the transaction, will show the loss they sustained; and if this be a correct construction of the powers of the directors, they may continue to reduce the price of stock, at every subsequent subscription, down to five or ten dollars a share, distributing the loss upon prior stockholders. The last subscribers, at whatever rate, would stand on an equality as to future dividends, and in all other respects, with the previous subscribers for stock, who had paid in full for their shares. The injustice of such a scheme requires no demonstration. It is in conflict with the charter. From the high character of the individuals who compose this company, I feel bound to say that in my judgment their error has arisen from a misconstruction of their corporate powers. But the principles of law apply to the act, and not to motive, where no moral turpitude is involved. I think the subscription of the plaintiff, as made, was void." [1]

§ 1594. May Issue Its Stock at Par in Payment of Its Debts.—It may be stated as a general principle, subject to possible exceptions, that a corporation having unissued or potential stock and at the same time outstanding debts, may issue its stock at par in payment of such debts. In other words, it may take its own obligations in payment of its shares. This is nothing more than exchanging one kind of corporate obligation for another. It clearly follows from principles already stated, that this may be done; for it would be idle to require the corporation to go through the form of receiving payment of its shares in money and then paying out the same money in the cancellation

[1] Sturges *v.* Stetson, 1 Biss. (U. S.) 246; *s. c.* 10 Myer Fed. Dec., § 147.

of its debts; by an arrangement with its creditor it may issue the one as an offset to the other, without going through the formality of exchanging checks. Accordingly, it has been held that a corporation having unissued stock, may issue certificates of it and take in payment of it its own money bonds.[1]

§ 1595. **Issuing Shares at Less than Par to Pay Past Indebtedness.** — There is judicial authority for the view that if a corporation being indebted arranges to pay its debts in stock certificates at less than their par value, the persons receiving such certificates will be assessable for any unpaid balances at the suit of creditors after the insolvency of the corporation.[2] When, therefore, a railway company, being indebted to a construction company, in the sum of $70,000.00, which it could not pay, issued to the members of the construction company, in satisfaction of the indebtedness, certificates of its stock of the face value of $350,000.00, it was held that the receivers of the stock were liable as stockholders to creditors of the company for the remainder, eighty per cent., of its par value.[3] And where a manufacturing partnership re-organized as a corporation and issued its stock to its creditors in satisfaction of their demands at less than par, it was held that creditors of the corporation, it having subsequently become insolvent, could charge the stockholders with the difference between the aggregate par value of their shares and the amount of the debts in payment of which

[1] Lohman *v.* New York &c. R. Co., 2 Sandf. (N. Y.) 39. Where officers of a corporation have for a long time been in the habit of issuing certificates of stock not before taken up, in exchange for the indebtedness of the corporation, a creditor who thus receives certificates for the bonds of the company, without inquiring of the authority of the officers, cannot afterwards withdraw from the arrangement, on the ground that the officers had only an implied authority to make such arrangement. Such transaction is binding on both parties. *Ibid.* A contract to take fully paid-up shares of a company in payment of a debt due from the company does not create a liability to pay money; and the acceptance of shares under such a contract does not amount to a "payment in cash" as required by the English Companies Act 1867. Re Johannesburg Hotel Co. (1891), 1 Ch. 119.

[2] Jackson *v.* Traer, 64 Ia. 469; *s. c.* 52 Am. Rep. 449. But see Van Cott *v.* Van Brunt, 82 N. Y. 535; Clark *v.* Bever, 139 U. S. 96; *s. c.* 35, L. ed. 88; 9 Rail. & Corp. L. J. 322; 11 Sup. Ct. Rep. 468; affi'g *s. c.* 31 Fed. Rep. 670; Fogg *v.* Blair, 139 U. S. 118; *s. c.* 35 L. ed. 104; 11 Sup. Ct. Rep. 476; *post,* § 1665, *et seq.*

[3] Jackson *v.* Traer, *supra.*

they were received.[1] The reason is said to be that "the sale of stock in a corporation by the directors at a less rate than the price fixed in the charter is a fraud upon the law and upon the stockholders." [2]

§ **1596. Further of This Subject.** — But it must be obvious on a little reflection that the application of the rule stated in the preceding section cannot obtain in the case of a *bona fide compromise*, where the creditor claims that more is due him than that for which he finally settles,— in which case he should not be held liable to pay to its creditors in the event of its insolvency, the difference between the par value of the shares received by him for the debt and what the corporation admitted to be due.[3] And it has been held, but on grounds which the writer has ventured to doubt,[4] that it can have no application in respect of a *past* indebtedness, where the corporation is already insolvent and cannot pay the creditor in money or tangible property and the shares are depreciated in value, and the creditor takes them at a reduced valuation on the principle of catching anything he can get, — provided, of course, the transaction is made in good faith.[5] And there is doubtful room for the view that such a transaction, in the absence of fraud, is good as between the corporation and a creditor,[6] though certainly between the corporation and one to whom the creditor subsequently transfers it

[1] Kehlor *v.* Lademann, 11 Mo. App. 550.

[2] Green's Brice's Ultra Vires, 143 note (a) citing Sturges *v.* Stetson, 1 Biss. (U. S.) 246; Fosdick *v.* Sturges, *Id.* 255; Mann *v.* Cooke, 20 Conn. 178; Fisk *v.* Chicago &c. R. Co., 53 Barb. (N. Y.) 513; O'Brien *v.* Chicago &c. R. Co., 53 Barb. (N. Y.) 568; Neuse River Nav. Co. *v.* Commissioners, 7 Jones L. (N. C.) 275. That one receiving stock at less than its par value will be compelled to make up the difference to creditors of the corporation, see Bailey *v.* Pittsburgh &c Co., 69 Pa. St. 334: Boynton *v* Hatch, 47 N. Y. 225; Osgood *v.* King, 42 Ia. 478.

[3] *Ante*, § 1553.

[4] *Post*, § 1666, *et seq.*

[5] Thus, a creditor of a corporation received in payment stock of the corporation at twenty cents on the dollar, as full paid stock. It was held that he was not liable to a subsequent creditor for the eighty per cent. unpaid, the corporation having been insolvent, its stock worthless, and the transaction having been in good faith; and that the Iowa statute could not be invoked in support of the claim that he was liable. Clark *v.* Bever, 31 Fed. Rep. 670; *s. c.* affirmed, 139 U. S. 96.

[6] *Ante*, § 1587, *et seq.*

for value.[1] Whether it would be impeached by stockholders, as *ultra vires* the directors, while the corporation continues a going concern, would, of course, be a different question.[2]

§ 1597. Issuing Shares as Collateral Security for Present Advances. — It is to be added in this connection that the principle which requires full payment of shares and which prohibits the issuing of shares as full paid unless they are full paid either in money or in money's worth, has been relaxed where the company itself has issued its shares to its creditor as collateral security for advances.[3]

1598. Issue of New Shares to Old Stockholders not to be Paid in Full. — A private corporation, whose stockholders were not individually responsible for its debts, increased its stock under authority of its charter, and subscriptions to the new stock were made upon an agreement, set forth in the subscription paper, that no assessment should be made and that each subscriber should be obliged to pay only $10.00 per share for the new stock, the par value of which was $100.00 per share. It was held that this provision was void as against creditors of the corporation who had not received notice of it prior to the contracting of their debts, and that such creditors could enforce payment for such stock to the extent of their demands.[4] The passage by a corporation of a resolution declaring that a certain per cent. (in the particular case, eighty per cent.) of its stock (in the particular case, of all its new and increased stock) should be non-assessable, and the issuing of certificates of stock to such of its shareholders as had paid 20 per cent. on their subscriptions, which certificates bear the words "*non-assessa-*

[1] See Crossley *v.* Louisiana Savings Bank &c. Comm'rs, 38 La. An, 74, 87.

[2] Liability of a creditor of insolvent corporation, accepting in good faith unissued stock at discount, to other creditors, denied 19 Am. & Eng. Corp. Cas. 267, *n.*

[3] Guest *v.* Worcester &c. R. Co., L. R. 4 C. P. 9; Ashworth *v.* Bristol &c. R. Co., 15 L. T. (N. S.) 561; Union Savings Asso. *v.* Seligman, 92 Mo. 635; *s. c.* 1 Am. St. Rep. 776; 15 S. W. Rep. 630; reversing 11 Mo. App. 142; overruling Griswold *v.* Seligman, 72 Mo. 110; and following Burgess *v.* Seligman, 107 U. S. 20; *s. c.* 2 Sup. Ct. 10. (Hough, C. J., and Sherwood, J., dissenting.) *Post*, §2150.

[4] Union Mut. Life Ins. Co. *v.* Frear Stone Man. Co., 97 Ill. 537; *s. c.* 37 Am. Rep. 129.

ble," does not have the effect to relieve the shareholders from their obligation to pay the full amount of their subscription. The directors and stockholders have *no power* to exempt stockholders from the liability, or to limit their liability within the full amount of the stock held as creditors of the corporation. The capital stock was held out as, and did represent part of, the assets of the company, upon the faith of which the public did business with it. The stock issued represented capital. Whatever was not paid was subject to be called for, if necessary, to meet liabilities.[1]

§ 1599. Making Payment by Reducing the Capital Stock.— Sometimes shareholders, who find themselves unable to pay for their shares, resort to the device of reducing their capital stock. Statutes which exist in most of the States provide how this may be done — generally by an amendment of the articles of association, so that the fact of the reduction goes upon record. In theory of law, *creditors* of the corporation who become such *subsequently to the reduction* are not prejudiced by it; and, as against *prior creditors*, subscribers cannot pay for their shares in this way, but remain liable to make good the full amounts of their original subscriptions so far as they have not been in fact paid.[2] To illustrate this, take a case where, before the corporation had incurred any debt the stockholders, whose subscriptions to its capital stock had never been made public, in good faith passed resolutions giving each subscriber fully paid up stock to the amount originally paid by him on his subscription, instead of issuing stock to the amount of the original subscription. It was held that the transaction was valid, and that the stockholders could not be held liable to creditors for the amount of the original subscription, except as to the deficiency between the amount of paid up stock so issued and the minimum allowed by the charter for the transaction of business.[3]

§ 1600. Where the Capital Stock is Increased.— The obligation to pay for shares which are issued in pursuance of a reso-

[1] Upton *v.* Jackson, 1 Flipp. (U. S.) 413; *s. c.* 10 Myer Fed. Dec., § 140.

[2] Re State Ins. Co., 14 Fed. Rep. 28.

[3] Hill *v.* Silvey, 81 Ga. 500; *s. c.* 8 L. R. A. 150; 8 S. W. Rep. 808; 39 Alb. J. 316.

lution to increase the capital stock of the company is of course just the same, and for the same reasons, as the obligation of subscribers to the original shares to pay for them; and if the original shares have been all paid up and an additional block of shares has been issued under the resolution to increase the capital stock, which shares are taken by the old subscribers but not fully paid, and a false certificate is filed to the effect that such shares has been fully paid up,—this will not make the shareholder's liability under the New York statute to pay for the benefit of creditors the entire subscribed capital, both original and increased, but only to pay the amount of the increase in respect of which the false certificate was made.[1] Accordingly, it has been lately held in England that subscribers to increased stock of a company to whom £10 shares were issued as paid up, on the actual payment of £3 per share, which was the market value of the old shares, which had been fully paid up at £10 per share, must be considered, in the distribution of assets on the voluntary winding-up of the company twenty years afterwards, as still indebted £7 per share to the company.[2]

Article II. Payment in Property.

[1] Veeder *v.* Mudgett, 95 N. Y. 295. The subject of the liability of the holders of shares, where there has been a fictitious increase of the capital stock, and of those who have received shares in payment of "stock dividends," is considered hereafter. *Post*, § 2087, *et seq.* See also an article by S. A. Wood, Esq., 24 Cent. L. J. 436.

[2] Re Weymouth &c. Steam Packet Co. (1891) 1 Ch. 66. That a corporation on *reorganization* may lawfully provide that debts of stockholders which remain unpaid for a certain time shall be extinguished by application of a sufficient portion of the new stock, see Reading Trust Co. *v.* Reading I. Works, 137 Pa. St. 298; *s. c. sub nom.* Reading F. Ins. Co. *v.* Reading Iron Works, 27 W. N. C. 91; 21 Pitts. L. J. (N. S.) 209; 48 Phila. Leg. Int. 108; 21 Atl. Rep. 170.

§ 1604. Payment in Property Allowed Where Statute does not Require Payment in Cash. — In the absence of a provision in the governing statute that the shares shall be paid for in money, they may be paid for in other property.[1] But whether a subscription may be made payable in anything but money must depend on two considerations: 1. The terms of the charter or governing statute. 2. The question whether the commodity is such a commodity as the company will necessarily have to buy in order to transact its work. If the charter or governing statute allows the payment to be made in goods, that of course

[1] Coffin *v.* Ransdell, 110 Ind. 417; Foreman *v.* Bigelow, 4 Cliff. (U. S.) 508; Phelan *v.* Hazard, 5 Dill. (U. S.) 45; Steacy *v.* Little Rock R. Co., 5 Dill. (U. S.) 348; Spargo's Case, L. R. 8 Ch. 407, 413; Drummond's Case, L. R. 4 Ch. 772; Maynard's Case, L. R. 9 Ch. 60; Ferrao's Case, L. R. 9 Ch. 355; Adamson's Case, L. R. 18 Eq. 670; Nichols' Case, L. R. 7 Ch. 533; and, on appeal to H. L., 26 W. R. 819.

ends the question. If the subscriber places in his contract of subscription the condition that he may discharge it by paying at a fair valuation goods of the character which the corporation will be required to buy, as, for instance, railroad iron for a railroad company, blank books and stationery for a banking company, and the like, — then it is supposed that this will be a valid subscription, and possibly so under charters or governing statutes which in terms require payments to be made in money; since it would be a construction too refined for ordinary purposes to require the subscriber to hand over to the corporation the money which the corporation would be at liberty the next minute to hand back to him in purchase of the goods: there would be no reason why they should not shorten the transaction by making the subscription payable in goods at a fair valuation.[1] In short, all judicial authority is agreed that no principle of law or public policy is violated by an agreement between parties about to form a trading corporation, by which the capital stock is to be represented by property which they contribute, if the transaction is free from fraud.[2]

§ 1605. **Payment in Property Generally Allowed.** — And even where the statute or other governing instrument, by its terms, requires payment in money, yet unless the language is such as to import a prohibition of anything but money, the courts are generally agreed that payment may be made in any kind of property which the corporation may lawfully purchase in the prosecution of its business, provided it be done in good faith.[3] The reason is that the law is practical in its requirements

[1] See the next section.

[2] Skinner *v.* Smith Moquette Loom Co., 56 Hun (N. Y.), 437; *s. c.* 31 N. Y. St. Rep. 448; 10 N. Y. Supp. 81. Where a corporation was organized on the basis of its stock being paid up in full, and it appears that one third was paid up in cash, and the remainder in a stock of goods whose sufficiency of value is not questioned, the requirements of the law are substantially complied with, and no cause of action in any form can be based upon a charge of non-payment of the capital stock. Kraft-Holmes Grocer Co. *v.* Crow, 36 Mo. App. 288.

[3] Pell's Case, L. R. 5 Ch. 11; Drummond's Case, L. R. 4 Ch. 772; Woodfall's Case, 3 De G. & Sm. 63; Phelan *v.* Hazard, 5 Dill. (U. S.) 45; *s. c.* 6 Cent. L. J. 109; Re Baglan Hall Colliery Co., L. R. 5 Ch. 346; Schroeder's Case, L. R. 11 Eq. 131. Lohman *v.* New York &c. R. Co., 2 Sandf. (N. Y.) 39. Searight *v.* Payne, 6 Lea (Tenn.), 283; Liebke *v.* Knapp, 79 Mo.

and does not require the parties to such a contract to do the vain thing of the subscriber finding money wherewith to pay his subscription, and the corporation then handing the money back to him in payment of property which it desires to purchase of him. That circumlocution may be avoided, and the property may be conveyed directly in satisfaction of what the subscriber owes for his shares. The general rule, then, is that if "a man contracts to take shares, he must pay for them, to use a homely phrase, '*in meal or in malt.*' He must either pay *in money or in money's worth;* if he pays in one or the other, that will be a satisfaction."[1] He may pay in any kind of property or services which the corporation has power to purchase for its use, provided the transaction be had in good faith and the property conveyed at a fair valuation.[2] It has been said, even under a statute which provides for payment in cash, that the payment may be in whatever, considering the situation of the corporation, represents to that corporation a fair, just, lawful and needed equivalent for the money subscribed.[3]

§ 1606. Payment must be in Money or Money's Worth. — We must proceed, then, with the proposition that shares of a corporation cannot be given away, but that they must be paid for at their par value, either in money or in money's worth. The officers of a corporation are the trustees of the subscriptions to its stock and hold them as a trust fund, and the trust cannot be defeated by any device short of actual payment in good faith.[4] But payment in actual cash is not in all cases required. It may be made in solvent securities,[5] in tangible property, or in

22, 28; *s. c.* 49 Am. Rep. 212; Coates' Case, L. R. 17 Eq. 169; Spargo's Case, L. R. 8 Ch. 407; Fothergill's Case, L. R. 8 Ch. 270; Brant *v.* Ehlen, 59 Md. 1.

[1] Lord Justice Giffard, in Drummond's Case, L. R. 4 Ch. 779; Sherwood, J., in Liebke *v.* Knapp, 79 Mo. 22, 27; *s. c.* 49 Am. Rep. 212.

[2] Libby *v.* Tobey, 82 Me. 397; *s. c.* 19 Atl. Rep. 904. Arapahoe Cattle & Land Co. *v.* Stevens, 13 Colo. 534; *s. c.* 22 Pac. 823; 28 Am. & Eng. Corp. Cas. 12 (services).

[3] Liebke *v.* Knapp, 79 Mo. 22, 24; *s. c.* 49 Am. Rep. 212.

[4] Wetherbee *v.* Baker, 35 N. J. Eq. 501. In some cases it has been held that payment can only be made in *specie*, as in case of a *banking* corporation: King *v.* Elliott, 5 Smed. & M. (Miss.) 428.

[5] Blunt *v.* Walker, 11 Wis. 334; *s. c.* 78 Am. Dec. 709; McRae *v.* Russell, 12 Ired. L. (N. C.) 224; Vermont Cent. R. *v.* Clayes, 21 Vt. 30.

labor, at a fair valuation, and under conditions and limitations hereafter stated.[1] But they must be paid for either in money or in some other valuable commodity.[2]

§ 1607. Further of the "Money or Money's Worth Rule."— "Upon a review of the authorities," says Davis, J., "we take the overwhelming weight to be that, after stock is subscribed and the company is organized, each subscriber becomes liable for the amount of stock subscribed by him, and he can only discharge this liability by paying it in money or money's worth, in the manner indicated by the subscription and the charter or by-laws of the company; and neither the officers of the company nor the stockholders can release him from his liability without the consent of every stockholder. Each subscription, when made, becomes a conditional contract with every other person who may subscribe that the amount subscribed shall, upon the formation of the company, be paid in accordance with the terms of subscription, and when the requisite stock is subscribed, and the company is duly organized, it becomes the offer or basis of credit to the public, or to all who may deal with it, and every subscriber participating in the organization thereby makes his subscription absolute, and is bound to pay it according to the terms of the charter and by-laws of the company, and he can discharge his liability in no other way. As between the corporators themselves, it may be that certificates of stock, by consent of all the members, may be issued as if paid up, without any actual payment in full, or even in part. But, however this may be, no device or arrangement among the corporators themselves, not made known to the public, by which the stock subscribed, instead of being paid, as the safe foundation of the credit and confidence which the company invites the public to give it, can be permitted to avail against the claims of persons who may deal with and trust the company upon the faith of its capital stock and corporate liability. By incorporation a privilege is conferred which exempts the individual members from all liability except that incurred by membership; and good faith to the public requires a

[1] *Post*, § 1642, *et seq.*

[2] Sickles *v.* Morton, 44 Hun (N. Y.), 623 mem.; *s. c.* 8 N. Y. St. Rep. 433.

strict compliance with all the obligations imposed by that membership." [1]

§ 1608. **English Statements of the Same Rule.** — The English courts have generally upheld contracts of subscription payable in specified property, settling down upon the broad doctrine that payment may be either "in money or in money's worth." [2] Upon this subject the English Court of Chancery seems to have agreed to a doctrine thus happily expressed by Lord Romilly, M. R.: "A person cannot sign the memorandum of association for shares generally, and afterwards say that some or all of them are paid-up shares, unless money or money's worth was actually paid by him, or on his behalf, for those particular shares; and also if he sign the memorandum of association in respect of shares there stated to be paid-up shares, while they are not really paid up, he will in my opinion, be liable to pay the amount due on the shares." [3] "That is to say," said Lord Chief Justice Giffard, in a subsequent case,— in which he declared the above language "perfectly accurate," — "if a man contracts to take shares he must pay for them, to use a homely phrase, in meal or in malt; he must either pay in money or in money's worth. If he pays in one or the other, that will be a satisfaction;" and in conclusion the learned justice formulated his views in the following very simple proposition, which, as already seen,[4] corresponds closely to the doctrine of the American courts: "A man who signs the memorandum of association agrees to become a shareholder, and so long as there are shares that can be allotted to him, he must fulfill that obligation." [5] This rule, founded on good sense and business convenience, has been adhered to by the English equity judges so far that, where there was a statute providing that "every share in every company shall be deemed and taken to have been issued, and to be held subject to the payment of the

[1] Marshall Foundry Co. *v.* Killian, 99 N. C. 501; *s. c.* 6 Am. St. Rep. 539, 543.

[2] Pell's Case, L. R. 5 Ch. 11; Drummond's Case, L. R. 4 Ch. 772; Baron De Beville's Case, L. R. 7 Eq. 11; Forbes and Judd's Case, L. R. 5 Ch. 270. These cases appear to resolve the doubts expressed in Pellatt's Case, L. R. 2 Ch. 527.

[3] Baron De Beville's Case, L. R. 7 Eq. 14.

[4] *Ante*, § 1138.

[5] Drummond's Case, L. R. 4 Ch. 778, 780.

whole amount thereof *in cash*, unless the same shall have been otherwise determined by a contract duly made in writing, and filed with the registrar of joint-stock companies, at and before the issue of such shares," [1] a credit by the company to a shareholder on account of a conveyance to them of specific property such as they were authorized to purchase was deemed a payment in cash.[2] The lords justices, in reaching this conclusion, proceeded upon the idea that the statute did not require a proceeding so senseless as that the company should hand over to the vendor of property which they were entitled to purchase a check in payment of it, and that he should hand back to them another check in payment of the shares which he proposed to purchase from them.[3] Accordingly, the rule was laid down, notwithstanding this statute, that in a proceeding to charge a shareholder as a contributory, any evidence that will support a plea of accord and satisfaction will present a good defense.[4] In a case in the House of Lords, Lord Blackburn understood the above statute to mean no more than that no contract for the issue of fully paid-up shares, without payment of their amount in cash, is to be valid unless it be in writing and be filed in the proper office, and that, in the absence of registration, the full value of the shares remains due; but, continued he, it does not say that the full amount shall be deemed to be payable by any subsequent holder for value, even though he receives a certificate stating that the shares have been fully paid up.[5]

§ 1609. Rule where the Charter Allows Payment in Property. — It is obvious that a rigid rule applied to stock subscriptions payable in specific property, discharging the conditions as to payment and making the subscription payable absolutely in money, would in many cases impede the organization of useful corporations, and thus be detrimental to the business interests of the country, without producing any corresponding security to creditors. Accordingly, some of the States have enacted statutes like the following, relating to corporations for manufacturing, mining, mechanical, and chemical purposes, found

[1] Companies Act, 1867 (30 & 31 Vict. c. 131), § 25.

[2] Coates's Case, L. R. 17 Eq. 169; Spargo's Case, L. R. 8 Ch. 407.

[3] Fothergill's Case, L. R. 8 Ch. 270.

[4] *Ibid.*; Spargo's Case, L. R. 8 Ch. 407.

[5] Burkinshaw *v.* Nicholls, 26 W. R. 821.

on the statute-books of New York: "The trustees of such company may purchase mines, manufactories, and other property necessary for their business, and issue stock to the amount of the value thereof in payment therefor; and the stock so issued shall be declared and taken to be full stock, and not liable to any further calls; neither shall the holders thereof be liable for any further payments under the provisions of the tenth section of said act; but in all statements and reports of the company, to be published, this stock shall not be stated or reported as being issued for cash paid into the company, but shall be reported in this respect according to the fact."[1] This section has been construed to include the original capital stock of companies, as well as any *increase* of it; and when a subscriber has made a subscription payable in property embraced in the terms of the statute, he is discharged from further liability. But this rule is, of course, subject to the exception that the transaction may be impeached for *fraud*, and that the stockholder may be charged at the suit of a creditor by showing that the property turned in was known to be of less value than the price at which it was turned in; and it seems that a showing of this kind may be made without any allegation of fraud.[2] The same point was ruled by the Supreme Court of New York before the passage of the statute in question.[3]

§ 1610. What if Such Statute is Repealed after Subscription and before Incorporation. — In a case in Alabama it appeared that before the incorporation of a company subscriptions were made to its capital stock payable in land. At that time the statute allowed subscriptions to be paid in this way. Before the organization of the company was effected, the statute was changed so as to require payment in money. It was held that the original subscriptions having thus become illegal, the agreement of a subscriber to convey land could not be specifically enforced.[4] But it may be doubted whether this holding does not give an effect to the repealing statute which makes it impair the obligation of existing contracts, valid at the time when made.

§ 1611. Agreements to Pay in Property Collateral to the Contract of Subscription. — But where the shareholder becomes such by an original subscription, if his subscription is payable in anything except money, that condition should be expressed in

[1] 3 Edm. Stat. at Large (2d ed.), 741, ch. 333, § 2.

[2] Boynton *v.* Hatch, 47 N. Y. 225.

[3] Tallmadge *v.* Fishkill Iron Co., 4 Barb. (N. Y.) 382.

[4] Knox *v.* Childersburg Land Co., 86 Ala. 180; *s. c.* 5 South. Rep. 578.

the contract itself.[1] As against *creditors* of the corporation, he cannot set up a *collateral agreement* by which his subscription was to be payable otherwise than in money, at least where the corporation has no authority by its governing statute to receive payment except in money. If, for instance, the corporation is a railroad company, he cannot, as against its creditors, set up a collateral written agreement that it is to be paid in *land*,[2] or that a part of it is to be paid in *goods*.[3] These cases may be reconciled with some which are elsewhere considered,[4] on the ground that the power may be conceded to the corporation to accept payment in any commodity which it may lawfully buy whilst it continues a going concern; but as its creditors are entitled to be paid *in money*, collateral and unexecuted agreements with shareholders to receive payment for their shares in lands or goods are not good as against creditors after the company passes into liquidation. "Where the charter authorizes capital stock to be paid in property, and the shareholders honestly and in good faith put in property instead of money in payment of their subscriptions, third parties have no ground of complaint. The case is very different from that in which subscriptions to stock are payable in cash, and where only a part of the installments has been paid. In that case there is still a debt due to the corporation, which, if it become insolvent, may be sequestered in equity by the creditors, as a trust fund liable to the payment of their debts."[5]

§ 1612. **English Decisions on this Subject.**— Nor could a person who signed a deed of settlement of a joint-stock company, as an unconditional subscriber to 350 shares, escape liability as a contributory in respect of such shares on the ground that the provisional directors had agreed to give him for his services as promoter of the company £2,500 out of the funds of the company, and paid-up shares of the company to the value of £2,500. The case proceeds on the ground that various shareholders had subsequently signed the deed, presumably on the faith of this one being a shareholder, and that shareholders were

[1] *Ante*, § 1311.

[2] Noble *v.* Callender, 20 Oh. St. 199.

[3] Henry *v.* Vermillion &c. R. Co., 17 Oh. 187; *ante*, § 1305, *et seq.*

[4] *Post*, § 1644.

[5] Coit *v.* Gold &c. Co., 119 U. S. 345, per Mr. Justice Field.

not bound by an agreement of which they had no knowledge.[1] Upon a similar principle it has been held that payment by a special partner, *in goods*, of the amount agreed to be contributed by him, is not a compliance with the statute respecting limited partnerships; it must be paid in cash.[2] But where there was an agreement to take shares and to pay for them in goods, and the company became incapable of performing the condition on its part, — that is, became incapable of taking the goods, by reason of being wound up, — it was held that the subscriber was released, and could not be made a contributory.[3] The case in which this result was reached was heard before Lord Justice Turner and Lord Cairns, on appeal from a decision of Vice-Chancellor Wood, whose decree they affirmed. It is difficult to distinguish this case from another appeal heard before the same lords justices a few days before, which resulted in a different conclusion. There, a mercantile firm were induced by the promoter of a corporation to subscribe for 150 shares in a hotel company, of the par value of £10 each, upon the faith of an agreement that they should pay but 30*s* per share in cash and the rest in electro-plated cutlery, they stipulating, and the promoter agreeing, to have a resolution passed to the effect that they should not be called upon to sign the articles of association of the company. In short, the substance of the agreement was that they should take these shares, pay a stipulated installment in cash, the rest in goods at a certain price, when ordered by the company, and that they should not incur any other liability as shareholders. This agreement was subsequently ratified by the board of directors; the firm in question received the certificates, their name was entered upon the register, the goods were never ordered, but the company having been ordered to be wound up, it was held that they must go upon the list of contributories.[4]

§ 1613. Other English Cases Illustrating the Rule.—The doctrine that payment for shares may be either in money or money's worth was practically illustrated in a case where it was, in effect, held that the shares subscribed for by A. might be paid up by a credit given at the request of B., upon a judgment recovered against the company by B. Thus, B. recovered a judgment for £3,900 against a company in which A. was a shareholder. It was agreed between B. and the company that this judgment should be settled by the payment of £3,200 in bills of exchange, and placing to the credit of shares standing in A.'s name £700, so as to make these shares fully paid up. An ap-

[1] Nickoll's Case, 24 Beav. 639.

[2] Haviland *v.* Chace, 39 Barb. (N. Y.) 283.

[3] Pellatt's Case, L. R. 2 Ch. 527.

[4] Elkington's Case, L. R. 2 Ch. 511.

plication to have A. placed upon the list of contributories, on the ground that his shares were not fully paid up, was successfully resisted. The court regarded the transaction as exactly the same thing as if B. had received from the company the £700 in bank-notes, and then B. had said, "I wish to pay up the shares of my friend A.; there is the £700 in bank-notes back again." The fact that A. owed B. nothing, and the arrangement was made simply as an obligation to A., cut no figure in the case.[1]

§ 1614. Continued. — It would, however, be a misstatement of the views of Lord Romilly to allow them to rest in the sentences above quoted from his judgment. The case before him really turned upon the construction of the 14th section of the Companies Act, 1862;[2] and the view of Lord Romilly was that he could not make a distinction between one set of shares and another unless the distinction appeared on the memorandum of association. "But," said he, "if the distinction is already made on the memorandum of association, and the shareholder signs (for example) in respect of 100 shares generally, and in respect of 100 paid-up shares, then, though he is a contributory in respect of the first 100 shares, he is not, in my opinion, a contributory in respect of the 100 paid-up shares. Either the directors of the company had power to enter into a contract to give him paid-up shares, or they had not; in neither case does it appear to me that he can be made liable in respect of the paid-up shares. If they had the power, and he had the paid-up shares in respect of which the contract was made, he

[1] Ferrao's Case, L. R. 9 Ch. 355.

[2] This section reads as follows: "The memorandum of association may, in the case of a company limited by shares, and shall, in the case of a company limited by guarantee or unlimited, be accompanied, when registered, by articles of association signed by the subscribers to the memorandum of association, and prescribing such regulations for the company as the subscribers to the memorandum of association deem expedient. The articles shall be expressed in separate paragraphs, numbered arithmetically. They may adopt all or any of the provisions contained in the table marked 'A,' in the first schedule hereto. They shall, in the case of a company, whether limited by guarantee or unlimited, that has a capital divided into shares, state the amount of capital with which the company proposes to be registered; and in the case of a company, whether limited by guarantee or unlimited, that has not a capital divided into shares, state the number of members with which the company proposes to be registered, for the purpose of enabling the registrar [of joint-stock companies in general] to determine the fees payable on registration. In a company limited by guarantee or unlimited, and having a capital divided into shares, each subscriber shall take one share, at least, and shall write opposite to his name in the memorandum of association the number of shares he takes."

could not, being a holder of paid-up shares, be put on the list of contributories except by his own consent. If they had not the power, the shares are nothing, and no shareholder is deceived, because he had notice of the transaction. The 100 shares for which he has subscribed without qualification are sufficient to satisfy the statute. But when he subscribes for paid-up shares alone, and they are not paid up, then the subscriber is liable to calls on all the shares, and will be made a contributory accordingly; because, as I have remarked, no distinction can be made between shares which appear on the memorandum of association to be all in the same category. Of course he will be allowed on account all moneys paid by him in respect of such shares, or money's worth given for them. Such a case is quite distinct from one where the contributory subscribes for a number of shares generally, and for another number of shares as paid up; for the latter set the contributory cannot be made liable."[1]

§ 1615. **Continued: The Recent English Doctrine.**— The doctrine which upholds the payment of shares in property, even where the governing statute requires payment in cash or in part cash,[2] has demoralized the law to such an extent as to sanction payment in almost anything which the parties may agree to be worth the value of the shares, so that blocks of shares may be issued in a round lump in exchange for an unagreed and indeterminate amount of newspaper puffing and influence,[3] or even for patent rights, which in many cases are mere potentialities, having no certain value whatever. Many of the decisions upholding the payment of shares in property proceeded in the face of statutes requiring the payment to be made in cash. Such, for example, was Spargo's case,[4] where the statute recited that "every share in any company shall be deemed and taken to have been issued and to be held subject to the payment of the whole amount thereof in cash." A more explicit and unambiguous legislative command could not have been framed; and yet the court, setting its own view of what was expedient and of what was required for business convenience, above the command of the legislature, held that payment might be made in any species of property which the corporation had the power to purchase,

[1] De Beville's Case, L. R. 7 Eq. 11.

[2] *Ante*, § 1592, *et seq.*

[3] Liebeke *v.* Knapp, 79 Mo. 22; *s. c.* 49 Am. Rep. 212; *post*, §§ 1648, 1649.

[4] L. R. 8 Ch. 407.

and that the court would not require the parties to go through the useless form of merely exchanging checks. After twenty-five years experience with the demoralization produced by this unfaithful interpretation of the statute, Lord Halsbury, L. C., sitting in the Court of Appeal, expressed his strong disapprobation of it, but felt himself bound to follow it until it should be overruled in the House of Lords.[1]

§ 1616. **True Value Rule.**— A stricter rule is applied by some courts, and one better calculated to protect the rights of the public who deal with corporations. It is that payment of corporate stock in anything except money will not be regarded as payment, except to the extent of the *true value* of the property received in lieu of money, and regardless of the question of fraud.[2] Under either theory, where stockholders turn over property of a *fictitious or imaginary* value in payment of their shares, this is no payment as against creditors of the corporation.[3] Under this rule, in an action to charge a stockholder with the corporate debts up to the amount of his stock, because the stock has been issued for property not worth its par value, it is not necessary to prove that the trustees were guilty of fraudulent intent;[4] but the true inquiry will be what was the *reasonable value*, or the reasonable market value of the property conveyed

[1] Re Johannesburg Hotel Co. [1891], 1 Ch. 119, 129. Referring to Spargo's case, the Lord Chancellor said: "I venture to doubt whether what is described by those eminent judges as the absurdity of handing money backwards and forwards when two people have cross demands, is so great as the absurdity of construing the words 'payment in cash' as payment without cash."

[2] Libby *v.* Tobey, 82 Me. 397; *s. c.* 19 Atl. 904; Shickle *v.* Watts, 94 Mo. 410; Farmers Bank *v.* Gallaher, 43 Mo. App. 482. This doctrine, that as against creditors of the corporation, transfers of property in payment of shares will only be regarded as payment to the extent of the actual value of the property, was laid down in an early case in the Supreme Court of New York, Tallmadge *v.* Fishkill Iron Co., 4 Barb. (N. Y.), 382. Later decisions seem to have modified the rule: Van Cott *v.* Van Brunt, 82 N. Y. 535, 542. Gamble *v.* Queens County Water Co., 123 N. Y. 91; *s. c.* 9 L. R. A. 527; 33 N. Y. St. Rep. 88; 8 Rail. & Corp. L. J. 484; 25 N. E. Rep. 201 (under N. Y. Laws 1848, Ch. 40, § 2.); reversing *s. c.* 52 Hun (N. Y.), 166.

[3] Alling *v.* Wenzell, 27 Ill. App. 511.

[4] National Tube Works Co. *v.* Gilfillan, 124 N. Y. 302; *s. c.* 35 N. Y. St. Rep. 357; 9 Rail. & Corp. L. J. Rep. 270; 26 N. E. Rep. 538; affirming 46 Hun (N. Y.), 248.

or services rendered.[1] It is a just conclusion, where statutes or constitutional ordinances exist prohibiting the issue of stock except for money or property actually received, and requiring payments in property to be at its money value, that where payment of a stock subscription is made to a corporation at less than its actual value, the subscribers will be liable to creditors of the corporation in the event of its insolvency, for the difference between the actual value of the property conveyed and the amount of their subscriptions.[2]

§ 1617. Standards by Which to Determine the True Value Under this Theory. — It has been ruled that the true inquiry, in determining whether or not the price paid by a majority of the stockholders of a corporation for property is so excessive as to be a fraud *on the minority*, is what, under all the circumstances, is a fair value of the property to the company, considering its proposed use and the general purpose for which the company is organized.[3] In determining this question, where the property has been conveyed by the company to a director, and a minority of the stockholders are seeking to have the conveyance set aside as having been conveyed at a fraudulent over-valuation, it is proper to take into consideration the value of the time and the interest on the money which the director has expended thereon, and this may be added to its cost, and he may, in addition, be allowed a fair profit thereon, and whatever advantage he may have gained by a fortunate purchase of materials used.[4] It has been further reasoned that an order by a majority of the stockholders of a corporation to pay an excessive sum for property purchased for it, in stock and bonds, is not to be condemned as a fraud, unless the majority acted in bad faith, on which question the possible or probable *prospective value* of the property purchased may be considered.[5]

[1] Shickle *v.* Watts, 94 Mo. 410.

[2] Elyton Land Co. *v.* Birmingham Warehouse &c. Co., 92 Ala. 407; *s. c.* 25 Am. St. Rep. 65; 12 L. R. A. 307; 9 South. Rep. 129.

[3] Gamble *v.* Queens County Water Co., 123 N. Y. 91; *s. c.* 9 L. R. A. 527; 33 N. Y. St. Rep. 88; 8 Rail. & Corp. L. J. 484; 25 N. E. Rep. 201; reversing 52 Hun (N. Y.), 166.

[4] *Ibid.*

[5] *Ibid.*

§ 1618. Rule that the Over-Valuation must be Fraudulent.— Many cases unite on the general proposition that where the governing statute of a corporation authorizes its shares to be paid for in property instead of cash,[1] or where the law of the forum otherwise concedes this power to it,[2] the fact that they are so paid for, and at an over-valuation of the property, affords no ground of complaint to the creditors, provided such payment is made and accepted in good faith.[3] The fraud here meant is *actual fraud*, in the sense of a dishonest purpose, and not constructive or theoretical fraud.[4] "While the contract stands unimpeached," said Judge Dillon, "the courts, even when the rights of creditors are involved, will treat that as a payment, which the parties have agreed should be payment."[5] "The test," said Lord Justice Gifford, "to be applied is this: Could the company, by any proceeding, have set aside the transaction by which it was arranged that the owners of the colliery were to have paid up shares as the price of their interests in the colliery? And I say, on the evidence, that the company clearly could not. It was urged that the parties only agreed with themselves, and that therefore, there was no contract. But every company is started by parties agreeing among themselves, and it is idle to say that they have nobody to agree with. * * * It must be held that the persons who subscribed the memorandum of association have paid all that they are bound to pay. Creditors have no ground for complaint, for persons who are about to enter into

[1] Coit *v.* Gold &c. Co., 119 U. S. 343.

[2] Liebke *v.* Knapp, 79 Mo. 22; *s. c.* 49 Am. Rep. 212.

[3] Young *v.* Erie Iron Co., 65 Mich. 111; *s. c.* 31 N. W. Rep. 814; 8 West. Rep. 153; Phelan *v.* Hazard, 5 Dill. (U. S.) 45; Coffin *v.* Ransdell, 110 Ind. 417; Whitehill *v.* Jacobs, 75 Wis. 474; *s. c.* 44 N. W. Rep. 630; Dodge *v.* Havemeyer, 42 Hun (N. Y.), 659 mem. *s. c.* 4 N. Y. St. Rep. 561; Gamble *v.* Queens County Water Co., 123 N. Y. 91; *s. c.* 9 L. R. A. 527; 31 Am. & Eng. Corp. Cas. 313; 25 Abb. N. Cas. 410; 33 N. Y. St. Rep. 88; 8 Rail. & Corp. L. J. 484; 25 N. E. Rep. 201 (rev'g *s. c.* 52 Hun, 166; 23 N. Y. St. Rep. 409; 5 N. Y. Sup. 124); Bickley *v.* Schlag, 46 N. J. Eq. 533; *s. c.* 20 Atl. Rep. 250; 8 Rail. & Corp. L. J. 290; 31 Am. & Eng. Corp. Cas. 523; Fort Madison Bank *v.* Alden, 129 U. S. 372; *s. c.* 32 L. ed. 725; 5 Rail. & Corp. L. J. 423; 9 Sup. Ct. Rep. 332.

[4] Whitehill *v.* Jacobs, 75 Wis. 474; *s. c.* 44 N. W. 630; Fort Madison Bank *v.* Alden, 129 U. S. 372; *s. c.* 32 L. ed. 725; 5 Rail. & Corp. L. J. 423; 9 Sup. Ct. Rep. 332; Young *v.* Erie Iron Co., 65 Mich. 111; *s. c.* 31 N. W. Rep. 814.

[5] Phelan *v.* Hazard, 5 Dill. (U. S.) 45.

transactions of magnitude with an individual, make inquiry into the state of his circumstances; and so, if they enter into them with a limited company, it is their own fault if they do not inquire into the nature of the memorandum and articles, and look to the register of shareholders." [1]

§ 1619. **Error as to Value no Evidence of Fraud.** — As value is largely a matter of opinion, anticipation or belief,[2] and in the case under consideration the question being how much can probably be got out of the property by the corporation, it follows as a reasonable conclusion that the mere fact that the promoters or the contracting officers of the corporation put too high an estimate on the property is not evidence of fraud, though a gross and obvious over-valuation would be.[3] Another court has reasoned that, to justify the finding of fraud in such a case there must be either an actual fraudulent intent, or such reckless conduct as would indicate, without explanation, an intent to defraud.[4]

§ 1620. **Illustrations.** — There is a case in Pennsylvania where the charter of a coal company authorized it to "purchase land not exceeding one thousand acres," and to employ its capital in "purchasing and holding the lands aforesaid, with the improvements," etc. This was held sufficient to authorize the company to purchase of a third person certain coal lands, a harbor, and land adjacent thereto, and to issue their stock in payment of such lands at their appraised value under an arrangement by which the members paid for the lands and took corresponding credits on account of the sums due for the stock held by them, such credits paying such stock in full. This done, no further power existed on the part of the company to levy a further assessment upon its shareholders, even though the lands turned out not to have been

[1] Baglan *v.* Hall Colliery Co., L. R. 5 Ch. 346. To the same general effect are Pells' Case, L. R. 5 Ch. 11; Forbes & Judd's Case, L. R. 5 Ch. 270; Fothergill's Case, 8 *Id.* 270; Pritchard's Case, *Id.* 956; Schroeder's Case, L. R. 11 Ex. 131; Spargo's Case, L. R. 8 Ch. 407; Coates' Case, L. R. 17 Eq. 169, 177.

[2] That value is ordinarily proved by the *opinions* of witnesses, which opinions are not conclusive on the triers of the fact, see Winkler *v.* Railroad Co., 21 Mo. App. 109; 1 Thomp. Trials, §§ 380, 600, 1122.

[3] Coit *v.* Gold &c. Co., 119 U. S. 343; Carr *v.* LeFevre, 27 Pa. St. 413.

[4] Young *v.* Erie Iron Co., 65 Mich. 111; *s. c.* 31 N. W. Rep. 814; 8 West. Rep. 153. See also Boynton *v.* Hatch, 47 N. Y. 225; VanCott *v.* Van Brunt, 82 N. Y. 535.

worth the sum at which they were appraised. It followed that a creditor of the company could not maintain an action against a stockholder, treating his stock as not fully paid, — nothing appearing to show fraud in the transaction.[1] A careful analysis of this case will, it is believed, convince the judicious reader that it was badly decided on its facts, though the above statement of what it professes to decide reads well. - - - - A seemingly worse decision was rendered by one of the appellate courts of Illinois. The stockholders of a corporation had been allowed to pay their subscriptions by conveying, or causing to be conveyed, to the corporation, coal lands, the business of the corporation being to mine coal and to buy and sell coal lands, and the value thereof was *bona fide* fixed at $500,000, the whole amount of the capital stock, although the land cost only $57,000 when bought from the farmers. The court held that they were not liable as upon unpaid stock for the debts of the corporation. Nor could such a liability be imposed upon them by a resolution of the directors, subsequently made, without their assent, declaring the stock unpaid.[2]

§ 1621. Otherwise as to an Over-Valuation with Knowledge. — If there is any meaning at all in the proposition elsewhere stated[3] that subscribers to the shares of a corporation must pay for them either in money or in money's worth, and if this principle has any substance at all when appealed to for the protection of those who have given credit to the corporation, — it must follow that where property is turned in to the corporation in payment of its shares, under whatever scheme, at an over-valuation, to the knowledge of the contracting parties, this will be evidence of fraud such as will render the shareholder liable to make good to creditors of the corporation the difference between the par value of the shares and the real value at which the property was turned in.[4] In like manner the officers of a cor-

[1] Carr *v.* LeFevre, 27 Pa. St. 413.

[2] Peck *v.* Coalfield Co., 11 Ill. App. 88; *s. c.* on former appeal, 3 Bradw. (Ill.) 619, and 98 Ill. 139.

[3] *Ante*, § 1606.

[4] Boulton Carbon Co. *v.* Mills, 78 Iowa, 460; *s. c.* 5 L. R. A. 649; 43 N. W. Rep. 290; 6 Rail. & Corp. L. J. 417. Several cases make over-valuation with knowledge the test of the liability of the shareholder to creditors: National Tube Works Co. *v.* Gilfillan, 46 Hun (N. Y.), 248; *s. c.*, 11 N. Y. St. Rep. 533; affirmed, 124 N. Y. 302. Compare Gamble *v.* Queens County Water Co., 123 N. Y. 91; 9 L. R. A. 527; 31 Am. & Eng. Corp. Cas. 313; 25 Abb. N. Cas. 410; 33 N. Y. St. Rep. 88; 8 Rail. & Corp. L. J. 484; 25 N. E. Rep. 201; rev'g 52 Hun, 166; 23 N. Y. St. Rep. 409; 5 N. Y. Supp. 124. All that is necessary to establish the legal

poration are chargeable with fraud, at the suit of a judgment creditor, if they receive, in payment for stock, property at a valuation known to be in excess of its real value, and thereon issue paid-up certificates of stock.[1]

§ **1622. Illustrations.**—In an action to charge the holders of stock so issued, it appeared that the entire capital stock,—$300,000,—was issued to H., one of the trustees, in consideration of his assigning to the company two executory contracts for the purchase of mining property on which nothing had been paid; that the contract price of one was $30,000, of the other $10,000; that one third of the stock was transferred back to the company, to be sold to raise a "working capital," and was afterwards sold at from 40 to 60 cents on the dollar; and that the defendant, participating as trustee in the transaction, bought $25,000 of the stock at 40 cents. The jury found the value of the property to be $68,000. It was held: 1. That the facts justified a finding of fraud, and were sufficient to sustain a recovery. 2. That the action was not barred by an action brought against the defendant and other trustees under the general manufacturing act of 1848, to charge them with the same debt because of failure to make the annual report.[2] - - - - In another case it appeared that H. owned a narrow-gauge railroad twenty miles long and worth about what the rails would bring for scrap-iron. P., to whom H. was heavily indebted, refused to receive the road or its capital stock in payment. Thereupon H., in order to make use of the road to pay the debt, organized a company, subscribed for 2,500 shares of its capital stock at $100 each, caused eight men to subscribe for one share each, to enable them to become directors, and caused certificates representing 3,000 shares to be issued to L., for H.'s use and benefit. No money was paid for these shares and subscriptions; but they were regarded as paid for by the "enterprise," namely the widening of the gauge and extending the road twenty miles to meet another railway, and selling the road to the company itself at a price fifteen times its value, taking said stock and bonds in payment. H. sold to P. a portion of the bonds amounting to three times the value of

fraud and take the stock issued by a manufacturing corporation for the purchase of property out of the immunity assured to stock honestly issued in pursuance of the N. Y. law of 1853, ch. 333, is to prove: 1. That the stock issued exceeded in amount the value of the property in exchange for which it was issued. 2. That the trustees deliberately, and with knowledge of the real value of the property, overvalued it, and paid in stock for it an amount which they knew was in excess of its actual value. Douglass *v.* Ireland, 73 N. Y. 100.

[1] Osgood *v.* King, 42 Iowa, 478.

[2] Douglass *v.* Ireland, 73 N. Y. 100.

the road. On default in payment of the interest, P. obtained judgment on the bonds against the company. It was held, on a creditors' bill by P. and others against the company, and against H., and other stockholders, that the stockholders were liable to the amount of their respective subscriptions for payment of the judgment, notwithstanding a provision in the bonds that no stockholder should be individually liable therefor.[1]

§ 1623. Transfer of Worthless Patented or Unpatented Inventions. — Some difficulty may be experienced in applying the rule to property of so indefinite a value as a patent right. The transfer of a worthless patent right has been held not such a payment as would satisfy the Iowa statute;[2] and the transfer to a railroad company of certain patent rights of an unascertained value was held not payment of a stock subscription under the statute of New York.[3] In an action to enforce the individual liability of a stockholder for corporate debts, under Laws N. Y. 1848, c. 40, § 10, on the ground that the stock had not been fully paid in cash, or property fairly worth the par value thereof, it appeared that the stock was paid for in *unpatented inventions*, found by the jury to be worth $75,000, which were conveyed to the company through a trustee, in consideration of which the entire stock was issued to the trustee, to be held in trust as follows: $100,000 for the company; $50,000 for the defendant, in payment of a debt of $15,000 due him by the inventor; $5,000 for a third person, in payment of another debt of $2,500; $13,500 given away to various persons, to qualify them as trustees; and the rest for the inventor. It was held that a verdict for the plaintiff was supported by the evidence.[4] But an agreement between the owner of a patent right and a third party, that the latter should form a corporation to work the patent, and should issue to the former a certain number of full paid shares of the capital stock of the corporation for the transfer of the patent right, is, in the absence of

[1] Preston *v.* Cincinnati &c. R. Co., 36 Fed. Rep. 54; *s. c.* 4 Rail. & Corp. L. J. 436.

[2] Chisholm *v.* Forney, 65 Iowa, 333.

[3] Tasker *v.* Wallace, 6 Daly (N. Y.), 364.

[4] National Tube Works Co. *v.* Gilfillan, 124 N. Y. 302; *s. c.* 26 N. E. Rep. 538; affirming *s. c.* 45 Hun, 248.

fraud or of a purpose to impose on the public, a valid agreement.[1]

§ 1624. View that the Contract Must be Impeached for Fraud in a Direct Proceeding. — There is a view, seemingly confined to two or three decisions, that the creditors of the corporation cannot charge the stockholder with the difference between the agreed and the actual value of the property delivered in payment of his shares, until the transaction has been impeached for fraud in a direct proceeding.[2] But it does not appear from these decisions what proceeding the creditor of the corporation is expected to take in order to impeach the transaction, — whether a bill in equity in which the corporation, the directors, and the shareholders are made parties, or what.

§ 1625. When Assignee in Bankruptcy of Corporation Cannot Disaffirm. — It was held by Mr. Justice Clifford, of the Supreme Court of the United States, at circuit, that a mining corporation may issue shares to its directors, as fully paid up, in consideration of the conveyance of mining lands; and, although these lands be greatly over-valued, the assignee in bankruptcy of the corporation cannot, without disaffirming the contract of purchase, set up the claim that the property is not worth what it was valued at, nor can he on any ground seek redress against a *bona fide* purchaser of the stock in open market. Among other things the learned judge said: "Nothing can be plainer in legal decision than that the title to the mineral land passed to the corporation, and that the title to the paid-up stock passed to the directors. Being formally executed, the contract must stand until it shall be rescinded, or the assignee, if he prefers that course, may retain what the company received for the stock, and seek redress in damages against those who defrauded the corporation. And the redress is at his command; but he certainly can not be allowed to disaffirm the con-

[1] Beyrich *v.* Liebler, 50 Hun (N. Y.) 606 mem. *s. c.* 20 N. Y. St. Rep. 769; 3 N. Y. Supp. 293. Compare Edwards *v.* Bringier Sugar Extracting Co., 27 La. An. 118.

[2] Coffin *v.* Ransdell, 110 Ind. 417, 424; Phelan *v.* Hazard, 5 Dill. (U. S.) 45; Brant *v.* Ehlen, 59 Md. 1. Compare Coit *v.* Gold &c. Co., 119 U. S. 343.

tract only in part, and affirm it as to the residue, as he must do in order to maintain the present suit."[1]

§ 1626. **Whether Fraudulent Over-Valuation should be Pleaded.** — There may be ground for a difference of opinion as to whether, in an action by a judgment creditor of the corporation against a shareholder to charge him in respect of his unpaid subscription, where the corporate records show that it has been paid, or where the stock certificate so recites, it is necessary to allege and prove that it was issued for property at a fraudulent over-valuation. In a case often cited it was held by a majority of the New York Court of Appeals that it is not necessary either to allege or to prove fraud.[2]

§ 1627. **Manner of Pleading It.** — A complaint, in an action by a receiver of a corporation, to collect an unpaid subscription, which alleged that property turned over to the corporation by the defendant in payment of his subscription, had been vastly over-estimated in value, has been held bad on demurrer, for failing to charge that the corporation was in some way misled or over-reached by the defendant as to the situation or value of the property, or that the transaction was merely colorable, or a device to absorb the capital stock without paying what was regarded and agreed upon as an equivalent.[3]

§ 1628. **Consideration Shown by Parol.** — The true view, and the one adopted expressly or tacitly in nearly all the decisions is that, in a proceeding by a shareholder or his representative against the corporation, the real consideration of the issue of the shares may be shown by parol, notwithstanding the corporate record. Where the record shows that the shares have been paid up, this does not, for instance, prevent a creditor, proceeding by motion under the Missouri statute, from showing that, in point of fact, they were not paid up; since "it is always competent to explain or contradict the consideration clause even

[1] Foreman *v.* Bigelow, 4 Cliff. (U. S.) 508.

[2] Boynton *v.* Hatch, 47 N. Y. 225.

[3] Coffin *v.* Ransdell, 110 Ind. 417; *s. c.* 11 N. E. Rep. 20; 9 West. Rep. 33.

in a deed; such clause possessing only the force and character of a receipt."[1]

§ 1629. **Trial by Jury on the Question of Fraud.**—Whether the question of fraudulent over-valuation of the property conveyed in payment of the shares will be tried by judge or by jury, depends of course, upon the nature of the action or proceeding, and the rule of the particular forum. If the suit is in equity, it will be triable by the judge sitting as a chancellor; if it is at law, it is ordinarily triable by jury. If it is by motion for execution by a judgment creditor, under the Missouri statute, it is triable by the judge.[2] In any case whether it is triable by jury or not, if he objects to the submission of the question to the judge, on well settled principles the unsuccessful party cannot raise the objection for the first time in the appellate court.[3] In every case of this kind tried by a jury, the question of fraud, being one of fraud in fact, as distinguished from fraud in law, must be submitted to the jury if there is substantial evidence tending to show fraud, and especially if there is opposing evidence.[4] Even where there is no opposing evidence, there is always the opposing *presumption* of honesty and right-acting; and it will always be a question for the jury whether the evidence adduced to show fraud is sufficient to overcome this presumption, unless possibly in extreme cases where, as in actions for negligence, fair-minded men could not differ on the question, when, according to some theory, the court may direct a verdict in favor of the conclusion of fraud.[5]

1630. **Effect of Knowledge on the Part of Creditors.**—Circumstances may also exist which will create equitable estoppels against creditors. Such, it seems, will be the case where a party, with full knowledge of the manner in which the shares have been paid for, purchases some of them, and subsequently,

[1] Liebke *v.* Knapp, 79 Mo. 22, 26; *s. c.* 49 Am. Rep. 212. To this point see Fontaine *v.* Boatmen's Savings Institution, 57 Mo. 561; Hollocher *v.* Hollocher, 62 Mo. 267; Baile *v.* Insurance Co., 73 Mo. 371.

[2] *Post,* §3613.

[3] Dodge *v.* Havemeyer, 42 Hun (N. Y.), 659 mem. *s. c.* 4. N. Y. St. Rep. 561.

[4] Lake Superior Iron Co. *v.* Drexel, 90 N. Y. 87.

[5] Frankenthal *v.* Goldstein, 44 Mo. App. 189 (cases reviewed).

with full knowledge of the nature and terms of the original transaction, purchases its mortgage bonds and thereafter seeks to charge other stockholders on the theory that their shares are not fully paid up.[1] But this decision does not rest on the doctrine of equitable estoppel. The true principle is that a creditor who deals with the corporation with full knowledge of the manner in which, if at all, its shares have been paid for, is not defrauded or prejudiced by the transaction which has resulted in the alleged payment.[2] And it has been held that a stockholder to whom the corporation is indebted is not within the rule which enables the creditors of the corporation to charge its stockholder in the case of a fraudulent over-valuation of property conveyed in payment of shares, when such stockholder is found to have had actual knowledge of the manner in which the stock had been paid for.[3]

§ 1631. Part Cash and Part Property. — In the absence of statutory prohibition, a corporation which purchases property, intending to issue stock in payment therefor, need not make the whole payment in stock; it may issue stock for a portion, and pay in cash or issue bonds for the balance.[4]

§ 1632. Payment not Compellable except according to the Contract. — Upon a principle discussed elsewhere,[5] such a contract openly made is, in the absence of fraud, either wholly valid or wholly void. If it is valid, *both parties are bound* by it. If it is void, *neither party* is bound by it, and neither party can substitute *another contract* in the place of it which the parties have not made, without the consent of the other party. When, therefore, the president of a railroad company, who was authorized to collect subscriptions to the stock of the company, accepted the stock of another company in payment of a subscription, his

[1] Walburn *v.* Chenault, 43 Kan. 352; *s. c.* 23 Pac. Rep. 657.

[2] Deadwood First Nat. Bank *v.* Gustin-Minerva &c. Co., 42 Minn. 327; *s. c.* 44 N. W. Rep. 198; 30 Am. & Eng. Corp. Cas. 122.

[3] Whitehill *v.* Jacobs, 75 Wis. 474; *s. c.* 44 N. W. Rep. 630.

[4] Gamble *v.* Queens County Water Co., 123 N. Y. 91; *s. c.* 9 L. R. A. 527; 33 N. Y. State Rep. 88; 8 Rail. & Corp. L. J. 484; 25 N. E. Rep. 201, reversing 52 Hun (N. Y.), 166.

[5] *Ante*, § 1308 *et seq.*

company was bound by his act in such a sense as not to be able to maintain an action for payment against the subscriber.[1] There may be some difficulty in reconciling this holding with a case in Georgia, where it was held that the act of the directors of a corporation during the late civil war, in allowing subscribers to discharge their entire subscriptions in advance of the regular calls, in depreciated Confederate money, being *ultra vires* and void, did not have the effect of discharging *other subscribers* who had not enjoyed this privilege. The court proceeded on the ground that what had been done did not stand in the way of the company collecting from the favored subscribers the amounts really due from them.[2] But, in the absence of fraud, it is difficult to perceive why this should be allowed, after the suppression of the Southern Confederacy had rendered Confederate money wholly worthless, and had rendered it impossible to put the subscribers *in statu quo*, at least without crediting them with the value of the Confederate money at the time of their payments, as compared with gold.

§ 1633. When Subscription Payable in Property is Demandable in Money.— If the subscription is in terms payable in materials, and is not paid in materials according to the contract, it is demandable in money, and an action of debt will lie thereon.[3]

§ 1634. Rescission of Such Contracts. — We have already considered the power of directors to consent to rescissions of contracts of subscription to the company's capital stock, with the general conclusion that there is no such power. But it will not do to affirm this as an universal principle. The circumstances may be such that it will be greatly to the advantage of the corporation, and hence to the advantage of its creditors, to rescind it. Even where the shares were issued as fully paid up when nothing has been paid, and there was a controversy between the sharetaker and the other adventurers in the corpora-

[1] East New York &c R. Co. *v.* Lighthall, 6 Robt. (N. Y.) 407.

[2] Macon &c. R. Co. *v.* Vason, 57 Ga. 314.

[3] Haywood &c. Plank Road Co. *v.* Bryan, 6 Jones L. (N. C.) 82.

tion, which ended in a *compromise* which took the form of a rescission and a redelivery of the certificates, and they were afterwards again issued to *bona fide* takers, it was held that the first share-taker could not be charged at the suit of the creditors of the corporation who become such long afterwards, since there had been no diminution of the trust fund in consequence of the transaction, and they had not been prejudiced.[1] The same court have gone so far as to affirm in general terms, and without reference to special circumstances, that a stockholder who surrenders unpaid stock to the corporation is not liable to creditors of the corporation whose demands subsequently accrue;[2] but this statement was not necessary to the decision of the particular case, which really turned on another proposition, and it is so plainly opposed to all principle and authority that it must be regarded as a strange judicial aberration. If this were the law, a number of schemers could organize a corporation, subscribe to its stock, induce innocent persons so to subscribe, record the articles of association showing the names of the subscribers and the amounts of their subscription, induce the secretary of state to issue a certificate of incorporation to them, get themselves elected directors, and then release each other from their respective obligations, and retreat from it, leaving the innocent dupes in the lurch to meet the demands of creditors, who might become such on the faith of the subscribed capital as shown by the record. But while the law repudiates a principle that renders such things possible, it does not so far tie the hands of the corporation as to prevent it from making, through its directors, *bona fide compromises* with its shareholders;[3] nor can creditors complain of such compromises where they are made while the corporation is a going concern. Accordingly, in an action by the creditors of a corporation engaged in the manufacture of iron, to charge the defendant with a statutory liability as a stockholder, it was held that he might show in exoneration that he became a stockholder by transferring to the corporation a furnace owned by him, in exchange for the stock; and that, some of the stockholders being dissatisfied, he took back the

[1] Erskine *v.* Peck, 13 Mo. App. 280; *s. c.* aff'd 83 Mo. 465.

[2] Johnson *v.* Lullman, 15 Mo. App. 55; *s. c.* affirmed 88 Mo. 567.

[3] *Ante*, § 1553.

furnace and retransferred the stock, taking a deed for the furnace.[1]

§ 1635. Further of the Rescission of Such Contracts. — On a familiar principle the corporation cannot avoid such a payment *without restoring the thing received.*[2] When, therefore, the directors of the company passed a resolution to accept *certain book accounts* in exchange for the stock of the company, it was held that the company could not afterwards avoid the contract, on the ground that the director making the transfer of the accounts had voted for the resolution, without restoring to him the accounts.[3] So, although an agent, having authority merely to collect subscriptions, cannot, obviously, vary the contract by accepting payment otherwise than in money, according to its terms, yet the corporation must disaffirm and promptly restore the thing delivered in payment. It cannot, it has been reasoned, reject the thing delivered in payment, so as to work injury to an innocent subscriber.[4] Although such a contract may be *ultra vires,* yet equity will not aid either party to rescind it where it has been *executed* on one side, and the parties cannot be put *in statu quo,* — as where *bonds* had been given in payment of shares of the stock of an insurance company, on which the company had embarked in business — and this although the capital stock may not have been paid in good faith, and although the company may have embarked in business in violation of the provisions of its charter.[5] And although the entire subscription is secured by a *bond and mortgage* and the shares are placed in the subscriber's name on the books of the company and entered to his credit on the stock ledger, yet if it subsequently refuse to issue certificates to him or to permit him to transfer his shares on its books, this will not invalidate the bond and mortgage, or entitle him to a rescission in equity, on the ground of a failure of consideration;

[1] Morgan *v.* Lewis, 46 Ohio St. 1; *s. c.* 21 Am. & Eng. Corp. Cas. 605; 17 N. E. Rep. 558; 15 West. Rep. 445; 4 Rail. & Corp. L. J. 113.

[2] Nor can the assignee of the corporation. Foreman *v.* Bigelow, 4 Cliff. (U. S.) 508.

[3] Gurney *v.* Union Transfer &c. Co., 25 Jones & S. (N. Y.) 444; *s. c.* 29 N. Y. State Rep. 274.

[4] East New York &c. R. Co. *v.* Lighthall, 5 Abb. Pr. (N. Y.) (N. S.) 458; *s. c.* 36 How. Pr. (N. Y.) 481.

[5] Yard *v.* Pacific Mut. Ins. Co., 10 N. J. Eq. 480; *s. c.* 64 Am. Dec. 467.

for he has a complete remedy at law by the ordinary action for damages for the conversion of his shares.[1]

§ 1636. No Right of Action in Creditors against Directors for Fraudulent Over-valuation. — A fraudulent over-valuation of the property turned in to the corporation in exchange for its stock is a fraud on the corporation, and not upon its creditors, at least in the sense which gives them a right of action against the directors for damages sustained by them for the deceit,[2] though they may pursue the stockholders as the holders of unpaid stock. Whether this can be asserted as a universal principle applicable to such cases may be doubted. A case might be imagined where the corporation is gotten up with the stock paid for in property of a fictitious value, for the mere purpose of getting money by foisting upon persons thereby deceived its stock or bonds,— in which case, the courts, disregarding the mere form, would sustain actions for deceit against the individual conspirators.[3] But in every such case it is necessary in order to a recovery, for the plaintiff to show that he *relied* on the fraudulent representations;[4] and, as creditors of corporations seldom look at the record to see what their capital stock is, but generally inquire as to the amount of their tangible property, cases will not be frequent where the directors can be charged on the theory of deceit for a fraudulent over-valuation of the property received in payment of its capital stock.

§ 1637. Corporation a Purchaser for Value. — Where the subscriber has paid for his shares in land at a given valuation, the corporation is a purchaser for value, within the *recording acts*, and is not affected with knowledge of a defect in the title, which may be possessed by the conveying stockholder, although the latter is president of the corporation.[5]

[1] Thorp *v.* Woodhull, 1 Sandf. Ch. (N. Y.) 411.

[2] Priest *v.* White, 89 Mo. 609.

[3] Such were the cases of Watson *v.* Crandall, 78 Mo. 583; affirming *s. c.* 7 Mo. App. 233; Hornblower *v.* Crandall, 78 Mo. App. 581; affirming 7 Mo. App. 220; followed in Whiting *v.* Crandall, *Id.* 593; Baker *v.* Crandall, 78 Mo. 584; affirming 7 Mo. App. 564. *Ante*, § 1460 *et seq.*

[4] This was one of the grounds of the decision in Priest *v.* White, 89 Mo. 609. See *ante*, § 1476 *et seq.*

[5] Frenkel *v.* Hudson, 82 Ala. 158; *s. c.* 60 Am. Rep. 736; 2 South. Rep. 758; *post*, § 5205.

§ 1638. These Principles Applicable to the Reorganization of Corporations. — It was pointed out by a learned writer[1] in the American Law Review that the principles which are under discussion in this chapter are peculiarly applicable in cases where corporations are reorganized. He said: "Many of the present railroad corporations of this country are built upon the ruins of their predecessors. A company that built, or partly built, a line of road, having failed, and its mortgage bondholders having taken possession of the property, a new company had been organized by the bondholders and other secured creditors of the old company, who become shareholders in the new company. The members of the new company have received shares of stock for their interest in the property transferred to the company. The inquiry arises whether any legal or practical objection can be taken to the validity of stock taken and paid for in this manner. It is assumed that the bonds and other debts of the prior corporation were valid and legitimate debts of that corporation; that these creditors legally acquired possession of its property upon the default of that corporation in paying these debts or the interest upon them; and that these creditors have proceeded in good faith to form a new corporation, and to become members of it. If the laws of the State in which the corporation is organized make no provision for a reorganization by such bondholders, and moreover do not provide that payment for subscriptions for stock shall be made in cash, the validity and effect of the issuing of shares of stock to such bondholders in proportion to their interest in the property, must be determined by the general principles of the common law applicable thereto." After stating in a summary way what those principles of the common law were, he concluded thus: "Much, if not all, that has been said upon this point, is applicable, in case a corporation is reorganized without a foreclosure of any mortgage upon its property. Thus, supposing that the stockholders and secured creditors of an embarrassed railroad company agree upon a scheme of reorganization, whereby the stockholders surrender their shares, wholly or in part, and other shares, either preferred or common, are issued to the creditors in consideration of their releasing their

[1] Leonard A. Jones, Esq., of Boston.

claims and securities against the corporation. If such a reorganization is entered upon and carried out fairly and in good faith, it can not be doubted that the shares issued to such creditors would be fully paid up shares. In such case the shares issued to such creditors might even be regarded as paid for in cash, and not in property taken at a valuation; for the debts of the company, surrendered in exchange for stock, being legitimate and undisputed debts of the company, could not be liquidated without the consent of the creditors, except by the payment of money. Although the bonds and other debts of the corporation exchanged for stock might not be due and payable, it would be legitimate for the corporation to agree that they should be immediately payable. No valid legal objection could be taken to the issuing of shares of stock for such debts; and no valid legal objection could be taken to such shares when so issued, as not fully paid for."[1]

Article III. In What Kind of Property.

[1] 18 Am. Law Review, 256.

§ **1642. Doctrine of Preceding Article Restated.** — Except where the so-called "true value rule" obtains,[1] the whole discussion resolves itself into the following conclusions: A corporation may take in payment of its shares any property which it may lawfully purchase. Such a transaction is not *ultra vires* or void, but is valid and binding upon the original sharetakers and upon the corporation, unless it is rescinded or set aside for fraud. While such a contract stands unimpeached for fraud or otherwise, the courts, even where the rights of creditors are involved, will treat that as payment which the parties have agreed should be payment.[2]

§ **1643. Corporation cannot Accept Payment in Specific Property which it is not Authorized to Hold.**— A corporation cannot accept payment for shares in specific property, unless such property is of a kind which the corporation is authorized by law to take and hold. Thus, a railway company which is not authorized to receive and hold lands and goods, cannot accept payment for its shares in lands or goods.[3] English courts likewise uphold payments for shares in specific property, provided it is of a kind which the company may lawfully take. Payment, in the view of those courts, is good if it be either in "money or money's worth."[4] But of course a steamship company, could not issue its shares in payment for a mine, nor a mining company its

[1] As to which see *ante*, § 1616.

[2] Phelan *v.* Hazard, 5 Dill. (U. S.) 45; *s. c.* 6 Cent. L. J. 109; Waterhouse *v.* Jamieson, L. R. 2 H. L. (Sc.) 29; Ex parte Currie, 32 L. J. (Ch.) 57; *s. c.* 3 De G. J. & S. 367; 7 L. T. (N. S.) 486; Carling's Case, 1 Ch. Div. 115; McCracken *v.* McIntyre, 1 Duv. (Canada) 479; Foreman *v.* Bigelow, 4 Cliff. (U. S.) 542; *s. c.* 7 Cent. L. J. 430; Carr *v.* Le Fevre, 27 Pa. St. 413.

[3] Noble *v.* Callender, 20 Ohio St. 199; Henry *v.* Vermillion &c. R. Co., 17 Ohio, 187. Compare Haviland *v.* Chace, 39 Barb. (N. Y.) 283.

[4] Pell's Case, L. R. 5 Ch. 11; Drummond's Case, L. R. 4 Ch. 772; De Beville's Case, L. R. 7 Eq. 11; Forbes & Judd's Case, L. R. 5 Ch. 270. This case appears to have resolved the doubts expressed in Pellatt's Case, L. R. 2 Ch. 527. See also Woodfall's Case, 3 De G. & Sm. 63.

shares in payment for a steamship; and a payment in such unauthorized property is no payment, but leaves the subscribers liable to pay over again in cash.[1] Questions, however, enter into this subject which do not concern the power of the corporation, but the rights of other shareholders, subsequently joining. If A. puts his name down for a certain number of shares, and there is a *secret agreement* between him and the directors of the company that he is not to pay in money, but in some other commodity, which may not be, in the opinion of the shareholders subsequently joining, of equal value to money, and this agreement is concealed from them, it works a fraud on them which a court of justice will not allow to be consummated; and such subscriber will be held to the liability which he ostensibly assumed.[2] And it has been held in England that although the company was not, at the time the subscription was made, disabled from taking the property — as where the payment was agreed to be made to a hotel company in cutlery which it would have been compelled to buy — yet if, by reason of its being wound up, it subsequently became disabled from using such property, it was not a binding agreement, but the subscriber would be compelled to pay his subscription in money.[3] And although a corporation may be expressly authorized by statute to receive payment for its shares in particular property, yet, if the payment is colorable and fraudulent, as where property is put in, through fraud and collusion with the directors, at more than its real value,— this will not be a good payment, but only a payment *pro tanto*, for so much as the property was really worth.[4] But in a case free from fraud, the mere fact that property was taken in payment for shares at an appraised value which was greatly *more than its real value*, furnishes no ground for treating it as other than a full payment, even at the suit of a creditor of the corporation.[5]

[1] See to the principle Noble *v.* Callender, 20 Ohio St. 199; Henry *v.* Vermillion &c. R. Co., 17 Ohio, 187. And the same is true of a payment for an interest in a limited partnership. Haviland *v.* Chace, 39 Barb. 283.

[2] Nickoll's Case, 24 Beav. 639; *ante*, §§ 1311, 1513; *ante*, § 1619.

[3] Elkington's Case, L. R. 2 Ch. 511.

[4] That it will be *no payment at all*, see Boynton *v.* Hatch, 47 N. Y. 225, 228.

[5] Carr *v.* Le Fevre, 27 Pa. St. 413; *ante*, § 1619.

§ 1644. What Kind of Property is "Money's Worth" to the Corporation. — Within the rule already stated a payment of shares may be made in any kind of property which the corporation, under its charter or governing statute, may take and hold; or any services such as it might lawfully contract for; or any solvent credits which it might lawfully acquire. It may be made in land, labor, materials useful for its business, or in satisfaction of damages or other liabilities.[1] A mining company may take payment in mining lands;[2] and payment may be made in *book accounts* where such accounts are incident to the business which the sharetaker has transferred to the corporation.[3] In a proceeding against a corporation to *forfeit its charter* and oust it of its franchises on the ground that the provision of its charter requiring that fifty per cent. of its capital stock shall be paid in money, has not been complied with, it will be a good defense to show that, at the time when the corporation commenced operations, it possessed property such as it required to possess and use in the prosecution of the business for which it was created, of a value equal to fifty per cent. of its capital stock in lawful money.[4] "If," said Bakewell, J., "it appeared that, at the date of signing the articles, the stock was fully paid up as to fifty per cent., in property fully worth in money fifty per cent. of the stock, the object of the provision we are considering seems to be attained. It must be immaterial to the State, and to the public dealing with the corporation, that the money is not actually on hand. Money is a mere measure of value. The corporation is not bound by law to keep fifty per cent. of its stock on hand in cash; and, if the directors have that sum on hand when the articles are signed, they may at once purchase goods with it. If it clearly appears that they have on hand when articles are signed, or immediately after the certificate of incorporation is issued, and when the company goes to

[1] Phila. &c. R. Co. *v.* Hickman, 28 Pa. St. 318; Arapahoe Cattle & Land Co. *v.* Stevens, 13 Colo. 534; *s. c.* 22 Pac. Rep. 823; 28 Am. & Eng. Corp. Cas. 12; Searight *v.* Payne, 6 Lea (Tenn.), 283; Carr *v.* Le Fevre, 27 Pa. St. 413 (Land.).

[2] Foreman *v.* Bigelow, 4 Cliff. (U. S.) 542; Phelan *v.* Hazard, 5 Dill. (U. S.) 45. Compare Re South Mountain &c. Mining Co., 7 Sawy. (U. S.) 30.

[3] Gurney *v.* Union Transfer & S. Co., 25 Jones & S. (N. Y.) 444; *s. c.* 29 N. Y. State Rep. 274.

[4] State ex rel. *v.* Wood., 13 Mo. App. 139, 143.

work, goods with which money to the amount of fifty per cent. of their stock may be acquired, there seems to be a substantial compliance.''[1]

§ 1645. Incorporating a Partnership and Transferring its Property in Exchange for Shares. — The ordinary way of reorganizing a partnership in the form of a corporation is to organize the corporation in form, whereupon the partners make a formal deed of the partnership to the corporation, in exchange for its shares, which are distributed among them according to their respective holdings in the partnership. That assets of the partnerships of all kinds may be thus turned in to the corporation in payment of its shares, where the corporation is capable of engaging in the business of the partnership, and is not disabled from holding the property which the partners may own, is a proposition which has the sanction of every-day experience, to say the least. Thus, it has been held that a corporation which has become the successor of a partnership to which the corporation is indebted for the business that it purchased, may receive the *notes* of the co-partnership which one of its stockholders holds, in payment for his share of the stock of the company.[2] Nor is there any difficulty, in theory of law, in the way of the individual partners conveying the partnership assets to the corporation, although they may be the sole corporators therein. The corporation being an artificial being, distinct in theory of law from the individuals who compose it, it is not the case of a man trying to make a contract with himself.[3]

§ 1646. Payment in Services at Less than Par Value of the Shares. — The same principle which allows payment for shares to be made in property, allows it to be made in labor, valuable and useful to the corporation.[4] But the same limitation

[1] *Ibid.* 143.

[2] Stoddard *v.* Shetucket &c. Co., 34 Conn. 542.

[3] St. Louis &c. R. Co. *v.* Tiernan, 37 Kan. 606; *s. c.* 15 Pac. Rep. 544.

[4] See a learned note on this subject in 19 Am. & Eng. Corp. Cas. 258. It is immaterial whether payment be made in money or in services, for the purpose of entitling the shareholder to participate in the business of the corporation, so long as there was an actual consideration. McComb *v.* Barcelona Apartment Asso., 56 Hun (N. Y.), 644; mem.; *s. c.* 31 N. Y. St. Rep. 325; McComb *v.* Cordova Apartment Asso. (Sup. Ct.) *Id.* 334; 56 Hun, 644 mem.

applies which has been pointed out in respect of the payment of shares in property; as against creditors of the corporation the transaction will be deemed no more than payment *pro tanto* where the property received for the shares is knowingly over-valued,[1] or what is the same thing, where the shares are issued at less than their par value.[2] "The directors have no more right to accept property worth manifestly less than the face-value of the stock, than they have to take depreciated or counterfeit currency as an equivalent on the same face-value. These principles are alike applicable to the purchase of services with an issue of stock. Many cases are reported in which shareholders held 'full-paid' stock, but, because the corporation had received no valuable or lawful consideration for the issue, the owner was held, in favor of creditors, to all the responsibility of a subscriber who is in arrear for unpaid stock. There is no reason why a like rule should not be applied, according to circumstances, to the case of a gross disproportion between the face-value of the stock and the consideration paid for it."[3]

§ **1647. Illustration.** — Accordingly where the president of a corporation made a demand against the corporation for compensation for his services to the extent of $2,500, and it was conceded by the directors of the corporation that his services were of this value, and the stock of the corporation being at that time of the market value of but 25 cents in the dollar, they issued to him two hundred shares of the aggregate par value of ten thousand dollars, but of the real market value of twenty-five hundred dollars in payment of his compensation; it was held that such shares were not in law to be deemed paid up shares, although they purported to be such upon their face, and were so issued to him, but that they were paid up to the extent of twenty-five per centum of their face value and no more; and accordingly, the corporation becoming subsequently insolvent and dissolved, a creditor could maintain an action against such shareholder in respect of the unpaid balance on the shares so received by him.[4]

§ **1648. Payment in Newspaper Puffing and Advertising.** — It has been held that if the corporation is about to undertake a great public enterprise, such as the spanning of the Mississippi river with a bridge

[1] *Ante*, § 1616, *et seq.*

[2] *Ante*, § 1563, *et seq.*

[3] Chouteau *v.* Dean, 7 Mo. App. 210, 215, opinion by Lewis, P. J.

[4] Chouteau *v.* Dean, 7 Mo. App. 214.

costing several millions of dollars, and desires to have the public mind awakened and informed touching the magnitude and importance of the undertaking and the prospective benefits to be derived from its being carried into successful execution, it will be competent for the corporation to make an agreement with the proprietors of a great newspaper to deliver to them a certain number of the paid-up shares of the corporation in a lump, in consideration of the paper supporting the enterprise by way of advertising and editorial commendation. The court, in so holding, reasoned thus: "If the company had seen fit to issue circulars containing facts, statistics and arguments in favor and furtherance of the enterprise, no doubt, it seems, could have arisen as to the lawfulness of such a method of making known the objects and benefits of the contemplated undertaking. If such a method be considered lawful, the disbursement of the funds necessary to pay therefor would seem to follow as an unavoidable consequence. But such a method of communication would, though lawful, have been unusual, while that employed was not only usual, but, it would seem, the most practical and satisfactory one for communicating with the public. It is true that the contract made with the proprietors of the Republican may be termed, in colloquial language, 'a lumping bargain,' but it is not easy to see how a contract more definite and particular in its terms could well have been made. Nothing is more customary than for a client to contract with his attorney to give him such a sum in gross for his services to be rendered in a particular case or during a certain period of time. Nothing is more customary than for a railroad corporation to make an agreement with a contractor for digging a cut or making a fill, agreeing to remunerate him therefor with a sum in gross. If such bargains are to stand, it is difficult to see how the one now under consideration, though occupying the same footing, should be seriously called in question." It was therefore held that the proprietor of the newspaper to whom the corporation had issued this paid up stock for such services could not be made liable to a creditor after the corporation had become, notwithstanding the energetic puffing, insolvent, on the theory that he had received his shares without paying for them."[1]

§ 1649. Continued — No Objection that Editorials were Published Gratuitously.— It was no objection to the payment of such shares to the extent before approved, in newspaper advertising, in the way of publishing statistical matter, etc., that at the same time the proprietors of the paper printed in the paper editorials favoring the work without making any charge therefor. "It would seem," said

[1] Liebke *v.* Knapp, 79 Mo. 22; *s. c.* 49 Am. Rep. 212; opinion by Sherwood, J.

Sherwood, J., "that the position of the plaintiff goes so far as this: that if the editors and proprietors of a newspaper, honestly and in good faith, favor and support editorially the prosecution of a great public work eminently beneficial to the people of the immediate vicinity, and indeed of the whole country, a work previously sanctioned by government authority,—that this ought to, and does render void any contract for remuneration for the publication in their paper of such articles as reading matter which tend to further and foster that work. Such a position we regard as wholly untenable, and these are our reasons therefor."[1]

§ 1650. In Case of Insurance Companies, Payment by Commissions on Business. — Insurance companies, in order to dispose of their shares, have frequently resorted to the device of appointing local agents on condition that they would take a certain number of shares, to be paid for in commissions on the business done for the company by them. These agreements have generally been held collateral to an absolute contract to take shares, and the subscribers have been put upon the list of contributories.[2]

§ 1651. Payment by Serving as Director and Giving the Corporation One's Business. — The president of a national bank informed a person who was a partner in a mercantile house that the bank was about to be reorganized, and that if he would act as a director, and if his firm would continue to give the bank their business and to use their influence in its behalf, they would give him ten shares of stock, which, by the national banking act,[3] were necessary to qualify a person to act as director. The person to whom this proposition was made acceded to it, was elected and served as a director, and his firm continued to give the bank their business until it became insolvent. Down to this time the person with whom this arrangement was made had never demanded or received his certificates of stock, but he now made a demand upon the bank for them, and the officers refused to deliver them. Thereupon he brought an action against the bank for the conversion of the stock. It was held that the agreement to give the stock to the plaintiff was valid, supported by a sufficient consideration, made by the plaintiff with the president professing to act for the bank, and, so far as appeared, ratified by the bank by receiving the benefits derived from it. The action might therefore be maintained.[4]

[1] See Liebke *v.* Knapp, 79 Mo. 22, 29; *s. c.* 49 Am. Rep. 212.

[2] Thompson's Case, 4 De G. J. & S. 749; *s. c.* 34 L. J. (Ch.) 525; Bridger's Case, L. R. 9 Eq. 74.

[3] Rev. Stat. U. S., § 5146.

[4] Rich *v.* State Nat. Bank, 7 Neb. 201; *s. c.* 29 Am. Rep. 382; 2 Nat. Bank Cas. 284.

§ 1652. Issuing Shares to Officers in Payment of Salaries. — Whether a corporation can issue its shares to its officers in payment of their salaries, or as compensation for special services, depends primarily on the question whether the directors have the power to make compensation for the services at all. We shall hereafter see [1] that unless there is a statute, and by-law made by the corporation at large, or with an authorization by the stockholders, directors cannot recover of the corporation compensation for their services as directors on the theory of an implied promise, nor vote themselves compensation out of its assets, especially after the rendition of the services. We shall see that the same rule applies to services rendered by directors in various official positions in the corporation, such as president, secretary, treasurer, member of the executive committee, etc., on the theory that these services may fairly be regarded as incident to the office of director; though a different rule applies in the case of the rendition by a director of services which are clearly outside the scope of his duties as director. When, subject to the operation of this restriction, the directors vote compensation to a corporate officer, or to one of their number, a valid indebtedness of the corporation to such person is established, and, on principles already stated,[2] this may be paid for by issuing shares of the company, provided there are unissued shares which may be so used.[3]

§ 1653. Miscellaneous Considerations as to Payment in Services. — It has been held that, under a contract to do work for a corporation, and receive payment in stock, an action will

[1] *Post*, §4380, *et seq.*

[2] *Ante*, § 1606 *et seq.*

[3] For a case where the stockholders of a corporation issued to themselves shares of the par value of $25 per share, "in consideration of valuable services, and in further consideration of the sum of $8.33 per share, to be paid by them," and where they also resolved to issue shares to certain officers of the corporation for their "labor and expense in organizing and obtaining valuable franchises," where the transaction was regarded as sufficiently free from the appearance of fraud as to entitle the officers to a *mandamus* to compel the issuing to them of the shares, — see State *v.* Timken, 48 N. J. L. 87; *s. c.* 2 Atl. 783; 4 East, 89; *sub nom.* Morton *v.* Timken, 2 Cent. Rep. 212.

lie, after performance, to recover the balance due, without proof of demand of the stock.[1]

§ 1654. Payment in Securities Other than Money. — Let us next consider the question under what circumstances payment may be made in securities other than money. Every subscription to the capital stock of a corporation creates a debt on the part of the subscriber to the corporation, except as to so much thereof as is paid at the time when the subscription is made. There is, of course, no rule of law or of public policy which prevents the corporation from accepting *collateral security* for such a debt; and a subscription which might well be rejected owing to the doubtful solvency of the subscriber, would properly be accepted on his giving such security. Accordingly, a bank formed under the New York banking law of 1838 might take a *mortgage* to secure the payment of a subscription to its capital stock;[2] and a stockholder in an Alabama banking corporation might make a mortgage of slaves to the bank for the same purpose.[3] Under a power to open books of subscription and in the absence of any restriction, etc., a railroad corporation may lawfully take a bond and mortgage in payment of a subscription to its capital stock.[4] Nor does a provision in the charter of such corporation, authorizing the directors to require payment on subscriptions to its capital stock, at such times, and in such proportion, not exceeding twenty-five per cent. at any one installment, and under such conditions as they shall deem fit, by implication, prohibit the company from taking such bond and mortgage.[5] Nor does the fact that the securities turn out to be of no value invalidate the certificates issued and delivered, in the absence of fraud,[6] —

[1] Hallihan *v.* Corporation of Washington, 4 Cranch. C. Ct. (U. S.) 304. Construction of a contract of subscription to the stock of a railroad company payable by taking and performing contracts for earthwork "by bidding for the same at public letting," — see Epps *v.* Mississippi &c. R. Co., 35 Ala. 33.

[2] Valk *v.* Crandall, 1 Sandf. Ch. (N. Y.) 179.

[3] Governor *v.* Baker, 14 Ala. 652.

[4] Western Bank *v.* Tallman, 17 Wis. 530; Lyon *v.* Ewings, 17 Wis. 61; Andrews *v.* Hart, 17 Wis. 297; Clark *v.* Farmington, 11 Wis. 306.

[5] Western Bank *v.* Tallman, 17 Wis. 530.

[6] Protection Life Ins. Co. *v.* Osgood, 93 Ill. 69. Where certain road stock, belonging to persons constituting a company for the running of a bank, was received from such persons as so much cash in payment of their sub-

provided, of course, they are taken *in payment*, and not as collateral merely.

§ **1655. Payment or Collateral Security?** — Whether the execution of a note and a mortgage securing the same is to be regarded as a payment of the subscription, or as collateral security merely, must depend upon the *intention* of the parties to the contract, as in any other case where the question of payment arises.[1] Where the evidence of such intention rests only in the writings which have passed between the parties (which is generally the case), the courts must decide it as a question of *interpretation*, and not submit it to a jury.[2] So deciding it, the Supreme Court of Ohio have held, construing a statute, where the question arose in respect of a life insurance company, that the effect of executing a note and mortgage in settlement of a stock subscription was a *payment* for the stock and a re-investment of the money by the corporation. The liability of the stockholder on the note and mortgage was no less than that of any other borrower; nor did his rights as a stockholder stand on any better footing than those who paid for their stock, but borrowed nothing from the company.[3] The Supreme Court of Indiana took a similar view of a transaction in which a person subscribed to the endowment fund of a university, with a right to six per cent. interest on his stock. It was held that the amount retained, for which the bond was given, was in the nature of a *loan* and that a failure to pay the interest was not a failure of the *consideration* of the bond.[4] But another court has regarded a subscription to a *guarantee fund* of an insolvent insurance company, secured by a transfer of railroad stocks, not a payment, but merely an obligation to pay in money in case the contingency should arise which required payment, which

scriptions, on the incorporation of the company, and the certificates of stock in such corporation showed that they represented equal shares of the whole capital, comprehending road stock and the cash paid in, such road stock became the property of the corporation, and all individual property in such stock was lost. Holbrook *v.* Union Bank of Alexandria, 7 Wheat. (U. S.) 555.

[1] 1 Thomp. Trials, § 1254; Schilling *v.* Durst, 42 Pa. St. 126.

[2] 1 Thomp. Trials, § 1065 *et seq.*

[3] Union Central Life Ins. Co. *v.* Curtis, 35 Ohio St. 343.

[4] Hazelett *v.* Butler University, 84 Ind. 230.

obligation was merely secured by the transfer of the collaterals.[1]

§ **1656. Payment in Certified Checks.** — On principles already considered,[2] a statutory requirement that subscriptions to capital stock shall be paid in cash is met by a payment by a certified check on a national bank, wherein the drawer has funds sufficient to meet it.[3]

§ **1657. Validity of Payment by Giving Promissory Note.** — The subscriber does not, of course, pay for his shares by merely giving his written *promise* to pay, *e. g.*, his promissory note, — at least unless such be the agreement and intention of the parties, and then the question would arise as to the power of the directors or managers of the corporation to make such an agreement.[4] Under a consitutional provision[5] which forbids the issue of stock by a corporation except for money paid, labor done, or property actually received, a note given to a banking corporation in payment of a subscription to stock is not void as against public policy, even though it could not be treated as part of the paid up capital. When, therefore, the subscriber delivered his note to the corporation in settlement of the first assessment and indorsed and delivered back the certificate of stock which he had received therefor, it was held that the corporation could recover on the note.[6] It is certainly a sound view that the subscriber cannot set up the invalidity of the contract and thus take advan-

[1] Russell *v.* Bristol, 50 Conn. 221.

[2] *Ante* § 1221, *et seq.*

[3] Re Staten Island Rapid Transit R. Co., 37 Hun (N. Y.), 422.

[4] Leighty *v.* Susquehanna &c. Co., 14 Serg. & R. (Pa.) 434. That a debtor does not pay a debt by giving *his own* promissory note in payment has been often held. Selby *v.* McCullough, 26 Mo. App. 72; Leabo *v.* Goode, 67 Mo. 126; Riggs *v.* Goodrich, 74 Mo. 112; Commiskey *v.* McPike, 20 Mo. App. 82; Steamboat *v.* Hammond, 9 Mo. 59; *s. c.* 43 Am. Dec. 536; Citizens' Bank *v.* Parson, 32 Mo. 191; Howard *v.* Jones, 33 Mo. 583; McMurray *v.* Taylor, 30 Mo. 263; *s. c.* 77 Am. Dec. 611. But whether the accepting of the note of a third person from the debtor is payment presents a closer question, as to which see Tobey *v.* Barber, 5 Johns. (N. Y.) 68; *s. c.* 4 Am. Dec. 326; Appleton *v.* Kennon, 19 Mo. 641; Leabo *v.* Goode, 67 Mo. 126; Riggs *v.* Goodrich, 74 Mo. 112; O'Brien *v.* Jones, 38 Mo. App. 90. See *ante*, §§ 1219, 1220.

[5] Const. Cal. Art. 12, § 11.

[6] Pac. Trust Co. *v.* Dorsey, 72 Cal. 56; *s. c.* 12 Pac. Rep. 49; 13 Pac. Rep. 148.

tage of his own wrong; for behind his promissory note stands his contract of subscription and his general obligation to keep faith according to his contract of subscription.[1] It is therefore unnecessary, in order to hold the subscriber in such a case liable on his note, to resort to the weak and fanciful reason of an early court that, although the contract of subscription was void, since the commissioners had power only to receive subscriptions in cash, yet the note would be regarded as having been given for the *purchase* of so much stock, and hence binding.[2] A bolder and more sensible view, taken in the case of a railroad company, was that, by virtue of the inherent powers of such companies to take and negotiate promissory notes in the ordinary course of their business, a promissory note may be received in payment of subscriptions to their capital stock.[3]

§ 1658. **Effect of Such Payment or Settlement.**— Where the subscriber gives his note in settlement of his subscription, and stock is issued to him therefor as fully paid up, the note is of course supported by a valuable consideration.[4] Such notes form, of course, a part of the assets of the corporation, and, as such, are a trust fund for its creditors. For instance, certain stockholders subscribed for their stock in an insurance company; they paid twenty per cent. in cash, and gave their notes to the company for the balance, without interest, payable upon demand when needed to pay losses. Dividends, from time to time declared by the company, were applied upon these notes, until, at the time of the great Chicago fire, October 9, 1871, only thirty-five per cent. remained unpaid on such notes. After the fire, the company becoming insolvent, each of these stockholders purchased policies from other persons, procured their adjustment by the company, taking certificates of loss for the amount, which certificates they then surrendered to the treasurer at par, in payment of their stock notes. In an action against such

[1] *Ante*, § 1220.

[2] Hayne *v.* Beauchamp, 5 Smed. & M. (Miss.) 515.

[3] Goodrich *v.* Reynolds, 31 Ill. 490; *s. c.* 83 Am. Dec. 240. That a note given to a corporation in payment of a stock subscription is valid even in the hands of a corporation, was asserted in Magee *v.* Badger, 30 Barb. (N. Y.) 246.

[4] Alexander *v.* Horner, 1 McCrary (U. S.), 641.

stockholders by the assignee of the company, it was held that these stock notes were a part of the capital stock of the company, and as such were a trust fund for the creditors; that they were in effect cash, which should have been paid in money into the treasury of the company for distribution among its creditors; that the notes were withdrawn from the treasury of the company by collusion with its officers; that the surrender of the certificates of losses to the treasurer at par, in payment of the stock notes, and their transfer to the stockholders were a fraud, such as would be set aside by the court without special reference to the provisions of the bankrupt law. The fact that some of these stockholders were also officers of the company made no difference, and those also who were only stockholders were held equally liable.[1] The company cannot, it would seem, retain the note and sue the shareholder for original assessments, but its remedy is upon the note; and it has been held that a subscriber who has given his note in settlement of his subscription, is not liable for assessments on the stock, where the certificates have been placed in *escrow* in the hands of a third person to be delivered to the subscriber when the note is paid, where the note has not been paid nor the stock transferred.[2] After the company has exercised its right to *forfeit* the stock — a subject hereafter considered[3] — by reason of the note not being paid at maturity, it cannot maintain an action upon the note, since it cannot have both the shares themselves and what the subscriber has agreed

[1] Jenkins *v.* Armour, 6 Biss. (U. S.) 312. Upon the point as to the time when *interest should begin to run* on these stock notes, whether from the date of demand by the assignee, or of the exchange by the stockholders, of the certificates of loss for their notes, it was held that, as against the company, if it had continued solvent, interest would only run from the time of a proper demand; but that, inasmuch as the liability of the stockholders arose from their own acts, under circumstances where they were properly chargeable as trustees who had wrongfully converted to their own use the assets of the company, when they made their exchange of certificates of loss for their notes, the effect was the same as though they had at that time taken and converted the amount in cash from the coffers of the company; and therefore they came within the rule that a trustee must pay interest from the date of the conversion, and judgment was rendered in each case with interest at six per cent. from date of the withdrawal of the stock notes. *Ibid.*

[2] Cormac *v.* Western White Bronze Co., 77 Iowa, 32; *s. c.* 41 N. W. Rep. 480.

[3] *Post*, § 1792, *et seq.*

to pay for them;[1] nor can it, after such a forfeiture, and especially after a material change has been made in its charter without the consent of the subscriber, by transferring the note to a third person, confer upon him a right of action against the subscriber.[2] But where the note has been assigned in good faith before maturity, and the subscriber pays it in good faith to the holder, the company can have no further claim against him, either upon the note or on the original contract of subscription.[3]

§ **1659. Such Notes When Negotiable.** — A note expressed to be "for value received in certificate of stock No. 650, for ten shares of the capital stock of the State Ins. Co.," and payable to the order of the treasurer "in installments not to exceed ten per cent. of each share, at thirty days' notice of calls from the board of directors," is a negotiable promissory note within the meaning of the Missouri Statute.[4]

§ **1660. How far Valid in the Hands of Indorsees.** — If a note given in payment for stock in a corporation is valid in the hands of the company, it is, of course, valid in the hands of any person to whom it is transferred by the company for value, with or without notice of the circumstances under which it was made.[5] If such a note is in form negotiable,[6] it is, of course, valid in the hands of an indorsee for value before maturity without notice, unless there is a statutory prohibition which goes so far as to invalidate it in his hands.[7]

[1] Ashton *v.* Burbank, 2 Dill. (U. S.) 435.

[2] *Ibid.* Of course the rule would be otherwise in case the note is transferred before maturity, for value and without notice to the transferee of the circumstances which create a failure of consideration. See next section.

[3] Alexander *v.* Horner, 1 McCrary (U. S.), 641.

[4] Stillwell *v.* Craig, 58 Mo. 24; see also Washington Co. Mut. Ins. Co. *v.* Miller, 26 Vt. 77; President &c. *v.* Hurtin, 9 Johns. (N. Y.) 217; *s. c.* 6 Am. Dec. 273.

[5] Magee *v.* Badger, 30 Barb. (N. Y.) 246. A second note given by such a subscriber, in settlement of an action brought to recover the amount due upon the original note, is also valid, it having a good consideration in the amount due upon the first. *Ibid.*

[6] *Ante*, § 1659.

[7] Alexander *v.* Horner, 1 McCrary (U. S.), 641. It has been held that a note given to a corporation for stock is valid in the hands of an indorsee without notice, though the statute forbids the receiving of a note or other evidence of debt in payment of any installment actually called in and re-

§ **1661. Indorsee entitled to Subrogation.** — Where the governing statute gives the corporation a *lien* on the shares for the unpaid balance due thereon, and a subscriber has given his note with an indorser in settlement of his subscription, the indorser, on the failure of the maker to pay the note, is entitled to have the stock applied in his exoneration.[1]

ARTICLE IV. NEW DOCTRINE THAT A CORPORATION CAN GIVE AWAY ITS UNISSUED SHARES.

§ **1665. Cases Denying or Limiting the Foregoing Principles.**[2] — Cases are not wanting which either deny entirely or essentially limit the principles discussed in the preceding articles. It has been held in a circuit court of the United States that a corporation may dispose of its stock for less than its face value, and that the transaction, as between the corporation and the purchaser, will be valid, unless prohibited by statute.[3] At a

quired to be paid, if it be not shown affirmatively that the note was given for stock called in. Wilmarth *v.* Crawford, 10 Wend. (N. Y.) 341.

[1] Petersburg Savings &c. Co. *v.* Lumsden, 75 Va. 327.

[2] Some cases of the kind about to be discussed have been already considered. *Ante*, § 1586, *et seq.*

[3] Harrison *v.* Arkansas Valley Ry. Co., 4 McCrary (U. S.), 264.

later date, the Supreme Court of the United States let itself down to the view that an active corporation may, even as against its creditors, for the purpose of paying its debts and obtaining money for the successful prosecution of its business, issue new stock and sell it for the best price that can be obtained.[1] Without accepting this principle, or conceding that the corporation, which is a trustee both for its shareholders[2] and for its creditors,[3] cannot undo the wrong, we can easily understand that circumstances may exist under which a corporation may sell its own shares at their market value, although this is less than their par value. Thus, a corporation may lawfully take its own shares to save a debt. Suppose it does so, and finds itself in urgent need of the very money which should have been paid to it by its debtor instead of the shares, it would be a hard and perhaps a mischievous rule that would prevent it from reselling the shares at their market value. There is then no difficulty in concurring with a judicial expression in New York to the effect that an agreement by a corporation to sell shares of its own stock for less than par is not void when it does not appear how the company acquired the stock.[4] But a decision of the highest court of that State to the effect that a railroad corporation may, in the absence of a prohibitory statute, pay for the construction of its road in its shares at their actual value, even though such actual value is less than their par value,[5] is entirely opposed to sound principle. Nor will the legal profession readily concur in a decision of the highest Federal tribunal, which sanctioned the issuing by a railroad company of its unissued shares at 20 cents on the dollar in payment of a debt, and which in its reasoning goes to the wild length of holding that a corporation may, so far as the rights of its creditors are concerned, give away its unissued shares, provided they are worthless at the time.[6] Another decision of the same court, rendered at the same term, sanctions the same principle, and holds that a railroad company can issue its shares to a contractor as a *bonus*, and that, the company sub-

[1] Handley *v.* Stutz, 139 U. S. 417; *s. c.* 35 L. ed. 227; 11 Sup. Ct. Rep. 530; 9 Rail. & Corp. L. J. 362.

[2] *Post*, § 2486.

[3] *Ante*, § 1569 *et seq.*

[4] Otter *v.* Brevoort Petroleum Co., 50 Barb. (N. Y.) 247.

[5] Van Cott *v.* Van Brunt, 82 N. Y. 535.

[6] Clark *v.* Beaver, 139 U. S. 89, 112.

sequently becoming insolvent, a creditor cannot charge the contractor as a holder of unpaid shares, but can at most charge him to the extent of their market value at the time when he received them from the corporation, which market value the creditor must aver and prove.[1]

§ 1666. New Doctrine that a Corporation can, as Against Creditors, Give away its Unissued Shares, Provided They are Worthless at the Time. — It is proposed to examine these extraordinary decisions of the Supreme Court of the United States more at length, as the writer believes that, while not professing to do so, they overturn all former rulings of the same court in respect of the rights of the creditors of corporations against the holders of unpaid shares, and totally obliterate the doctrine of that and other American courts, that the capital stock of a corporation is a trust fund for its creditors. In the first case,[2] a railroad company got into difficulties with the usual questionable practice of having its road built by a construction company whose president was also the president of the railroad company — the usual Credit Mobilier incident of railroad building. There had also been an overissue of its bonds, and it was practically insolvent and could not pay the construction company. So it concluded to settle with the construction company by issuing its stock to the construction company for what it owed it, at the rate of twenty cents on the dollar. This stock was issued and was turned over by the railroad company through its president, Greene, to the construction company, who received it through its president, the same Greene, and Greene received nine hundred and ten shares as his portion. No other payment on these shares was ever made. Greene subsequently died. Subsequently one Clark, a bondholder of the railroad company, recovered a judgment on his bonds, and thereafter brought an action against the administrator of Greene, it seems, under the terms of the Iowa statute, in the Circuit Court of the United States within the State of Iowa, to enforce satisfaction of his judgment out of what was due from the estate of Greene, as an unpaid balance upon the shares thus received by Greene. The

[1] Fogg *v.* Blair, 139 U. S. 118; *s. c.* 11 Sup Ct. Rep. 476.

[2] Clark *v.* Beaver, 139 U. S. 89; aff'g *s. c.* 31 Fed. Rep. 670.

Circuit Court held that he could not recover, and this decision is now affirmed by the Supreme Court of the United States upon error.

§ 1667. Continued: Doctrine that a Corporation Can Issue its Shares in Payment of Labor and Materials at Whatever they may be Worth at the Time.— Another decision of the Supreme Court of the United States already referred to,[1] must be quoted as laying down the doctrine that, while a corporation cannot in general give away its unissued shares, or issue them for less than their real value, yet it may issue them, in payment for work or otherwise, at whatever they are actually worth at the time: that is to say, if they are worth only one cent on the dollar at the time, the corporation may issue one hundred dollars worth of its shares at their nominal value, for one dollar's worth of work. Stripped of unnecessary details, the case was that a railroad company, being indebted to the plaintiff by judgment, employed a contractor to do certain grading, under a contract by which the contractor was to receive twelve thousand dollars a mile for the grading, and under which he received, in addition, eight hundred and fifty thousand dollars' worth, at the nominal value, of the shares of the company, — all of this for grading thirty-eight miles of main and two miles of side-track in a level country. Of course, after such a financial transaction the railroad company became insolvent. The contractor, becoming a stockholder to this extent, no doubt acquired such an influence in its board of directors as to enable him to make it insolvent. How its insolvency came about does not, however, appear; but the plaintiff, finding the company insolvent and his judgment unpaid, filed a bill in equity against the contractor who had thus become a stockholder, to charge him in respect of what was unpaid on his shares. In this bill the plaintiff charged that the work done by the contractor was not worth more than twelve thousand dollars a mile; that the mortgage bonds issued to him were a "full and adequate consideration for the work done," and that there was no consideration received by the company for the stock; in short, the meaning of his language was that the company had given away the stock to the contractor, and he charged that it was fraudulently done. The Supreme Court of the United States, after laying down the usual ground that stock subscriptions constitute a trust fund for creditors which cannot be given away or disposed of without consideration or fraudulently by the directors, and correctly stating that this is the law of Missouri as well as the doctrine of the Supreme Court of the United States, proceed to say — the italics

[1] *Ante*, § 1665; Fogg *v.* Blair, 139 U. S. 118.

being ours:—"It is averred in the bill, and the demurrer admitted, for the purposes of the hearing below, that full and adequate compensation for the work done by Blair and Taylor was $12,000 per mile in the company's first mortgage bonds. Assuming this to be true, if the stock issued to Blair and Taylor was of any considerable value at the time they received it, or if the circumstances attending its delivery to them indicated bad faith upon their part or upon the part of the corporation, different questions would arise from those now presented. *But the bill contains no allegation whatever as to the real or market value of the stock. The court cannot say, from any facts set forth in the bill as to the condition of the railroads in question, that the stock when delivered to the contractors was worth par, or that it had any substantial value. If, when disposed of by the railroad company, it was without value, no wrong was done to creditors by the contract made with Blair and Taylor.* If the plaintiff expected to recover in this suit upon the ground that the stock was of substantial value, it was incumbent upon him to distinctly allege facts that would enable the court — assuming such facts to be true — to say that the contract between the railroad company and the contractors was one which, in the interest of creditors, ought to be closely scrutinized. He seems to have carefully avoided making any allegation as to the real or probable value of the stock, and to have supposed that the court, in the absence of averment or proof to the contrary, would assume that it was worth par, or had substantial value. As he impugned the good faith of the transaction between the company and the contractors, it was incumbent upon him to state the essential, ultimate facts upon which his cause of action rested, and not content himself with charging, generally, that what was done was 'colorable,' a 'fraud,' a 'breach of trust,' and a 'scheme,' by which Blair and Taylor were to get the stock without paying for it. These are allegations of legal conclusions merely, which a demurrer does not admit.[1] It is consistent with the allegations of the bill, that the stock was absolutely without value when issued to Blair, and up to the time when the railroad and all the property appurtenant thereto was sold under the decree of foreclosure."

§ 1668. Comments on this Decision.—This decision affirms in a previous part of the opinion, the familiar doctrine of that court, and of every court that has a correct understanding of this subject, that a stock *subscription* must be paid up according to its terms; but it

[1] Citing Dillon *v.* Barnard, 21 Wall. (U. S.) 430, 437; United States *v.* Ames, 99 U. S. 35, 45; Pullman Company *v.* Missouri Pacific Company, 115 U. S. 587, 596; Ford *v.* Peering, 1 Ves. 72, 77.

announces the doctrine that a corporation may *sell* its stock for anything which it may happen to be worth at the time, or even give it away if it is worthless, and that the creditors cannot complain of this, if their security is not impaired. The contrary has been held in many cases, which have been considered elsewhere, some of which we cite again in the margin.[1] These and many other decisions affirm, as an elementary proposition in corporation law, that when a corporation issues its shares in the first instance, it is bound to get their par value in money or in property, in money or in money's worth. Though such a result was possibly not intended by the court, yet this decision seems to involve a total denial of this principle.

§ 1669. Continued: Refusing to follow the Construction Put by the Courts upon their Own Statutes of Incorporation. — The most regrettable feature of these decisions is that they involve, the one an indirect, and the other a direct refusal on the part of the Supreme Court of the United States to follow the decisions of the Courts of the States in which these controversies arose, which decisions involve the construction of their own statutes of incorporation in the particulars under consideration. The case last spoken of[2] arose with reference to a railroad corporation created and existing under the statutes of the State of Missouri and having a road in that State. The opinion purports to follow and administer the law of that State. That it is directly opposed to that law, as settled by the appellate courts of that State, every well informed lawyer in that State knows. This is shown by the following statute of that State: "The stock or bonds of a corporation shall be issued only for money paid, labor done, or money or property actually received."[3] If the decision on which we are commenting intends to draw a distinction between the case where a person *subscribes* for the stock and where it is *sold* or given away to him by the corporation, then it is to be observed that this distinction has been repudiated by the Supreme Court of Missouri in the following language: "No sound distinction can be taken between a purchaser of and a subscriber for stock, and the authorities generally take none."[4] On the same page of the opinion the Missouri court say: "The gist of this proceeding, and of plaintiff's right to the relief they seek, consists in this, that Watts is owner and holder of unpaid stock in the insolvent

[1] Chouteau *v.* Dean, 7 Mo. App. 210; Kehlor *v.* Lademann, 11 Mo. App. 550; Williams *v.* Evans, 87 Ala. 725; Sturges *v.* Stetson, 1 Biss. (U. S.) 246; Upton *v.* Jackson, 1 Flipp. (U. S.) 413; Union Mutual Life Ins. Co. *v.* Frear &c. Co., 97 Ill. 537; *s. c.* 37 Am Rep. 129.

[2] Fogg *v.* Blair, 139 U. S. 118.

[3] R. S. Mo. 1889, Sec. 2499; *Id.* 1879, Sec. 727.

[4] Shickle *v.* Watts, 94 Mo. 410, 419.

corporation. This causes a liability to attach to him as a stockholder, and it is quite immaterial whether he is in fact a subscriber or not. The taking of certificates of stock implies a promise to pay."[1] To this the court cite the decision of the Supreme Court of the United States in Webster *v.* Upton,[2] and the decision of the St. Louis Court of Appeals in Chouteau *v.* Dean.[3]

§ 1670. As Shown in the Missouri Case of Schickle v. Watts. — In the Missouri case of Shickle *v.* Watts,[4] the plaintiffs were judgment creditors of an Illinois corporation. It may be observed, parenthetically, that while the corporation was an Illinois corporation, the law of Illinois does not seem to have been specially pleaded or proved, and the questions were determined according to the law of Missouri and the general law. But we do not understand that the law of Illinois in the particular under consideration is different from the law of Missouri, or from any other law except what must now be accepted as the law of the Supreme Court of the United States. The plaintiffs brought a bill in equity against a Missouri stockholder of this Illinois corporation, to charge him in respect of what remained unpaid upon his shares for the purpose of satisfying their judgment. He was the owner of twelve hundred shares of its stock. The controlling question was whether he could be treated as holder of unpaid stock in the corporation. The facts were, that in 1874 he contracted with the corporation for the erection of its gas works in East St. Louis, Illinois. For this work he was to receive $80,000. Fifty thousand dollars of this sum was to be paid him in the mortgage bonds of the company, secured by a first lien on the "works, property, and franchises of the corporation;" and the residue, $30,000, was to be paid in cash. Concerning the cash payment, $30,000, it was stipulated that $13,000 "should be payable from the holders of the original $50,000 of stock, and the other $20,000 only from the other stock, thereafter to be disposed of by the corporation." And it was further stipulated, "that if the corporation failed to dispose of sufficient new stock to realize, from an equal assessment upon all the stock, enough to pay $20,000 when so due," then the defendant should "receive, in lieu of said $20,000, *cash stock of the corporation at the same rate as other stockholders in full compensation for his dues.*" He built the gas works as agreed, and received from the corporation $40,000 in its bonds, and realized from their sale over $38,000. The $13,000 was never raised by assessments upon the $50,000 of old stock, and was never paid to

[1] *Ibid.*
[2] 91 U. S. 65.
[3] 7 Mo. App. 215.
[4] 94 Mo. 410.

him. The company did not succeed in selling any of the new stock, from the sale of which the $20,000 was to be raised and paid to him. It did appear, however, that at various times the corporation issued to him, and that he received from it fifteen hundred shares of what was termed new stock. The par value of these shares was twenty-five dollars each, so that their aggregate par value was $37,500; he sold three hundred of these shares and, at the time when the bill in equity was filed, he was the owner of twelve hundred of them. No settlement was ever made between him and the corporation. The court found as a fact that $50,000 was a reasonable charge for the construction of the gas works, including a fair allowance for the profit of the contractor. The contract under which the fifteen hundred shares were issued to him provided that they should be issued to him "at the same rate it was issued to the other stockholders." He did not claim that it was issued to him in satisfaction of his demand, but the account between him and the company remained unadjusted. The other stockholders obtained their certificates of stock upon payment of $12.50 per share. The court said: "It results from this that, inasmuch as, between Watts and the company, he obtained his stock at $12.50, giving the company credit only at that sum per share, which for the fifteen hundred shares would amount to a credit of $18,750, paid to him with stock — taking this as the proper basis of computation, this would leave him still liable to the creditors of the corporation to the amount of $15,000 on the twelve hundred shares which he still retains. This must be so, if it be true that notwithstanding any understanding or agreement between the defendant and other shareholders and the corporation that they were not to be assessed any further on their shares, is of no avail as against corporate creditors. And this seems to have been the nature of the agreement between the corporation and its various shareholders: *i. e.*, that they were to receive their shares on payment of fifty per cent. of their par value, and so the court below has found. And that court has also found that the contract price for the gas works built was some seventy per cent. beyond a fair and reasonable price, and that the sum already paid on account of those works including bonds and stock amounts to $57,254, or about $7,254, more than the reasonable value of such works." The court, as above stated, denied the distinction between a case where one becomes a stockholder by subscription and by purchase, and re-affirmed the doctrine that the stock of a corporation is a trust fund for its creditors, and that it can only be disposed of by the corporation upon receiving therefor its full nominal value either in money or in property; and the court accordingly affirmed the judgment, holding the stockholder liable.

The court among other things said: "Where an agreement is entered into between a contractor and a corporation, whereby the former is to perform work for, or furnish material to, the latter, and to take unpaid stock in part or in full payment, such contractor, whether for labor or material, can only charge therefor the reasonable market value for such labor or material thus given in exchange; and that all agreements by corporations to pay more than such reasonable compensation will be disregarded and held for naught by the courts when the rights of creditors intervene." [1]

§ **1671. And by other Decisions in that State.** — In the case referred to in the preceding section the Supreme Court of Missouri quote to the last proposition, with approval, two decisions of the St. Louis Court of Appeals,[2] where it is laid down in language equally as explicit. Not only this case, but the two cases just quoted, are explicitly opposed to the present holding of the Supreme Court of the United States. In Chouteau *v.* Dean,[3] ten thousand dollars of the stock of a corporation was issued to an officer thereof in consideration of services rendered by him of the value of twenty-five hundred dollars, *the stock being taken at its market value of twenty-five per cent.* The court held that the officer nevertheless became liable to the creditors of the corporation to the extent of the difference between the value of his services and the par value of the stock. This decision has been quoted and followed again and again in that State. The court said: "It is settled American doctrine that every corporation holds its capital stock as a trust fund for the benefit of its creditors. The fund, however, does not exist until the stock is issued to the shareholders. Up to that point there is a mere possibility or privilege of creation of stock. When a share is issued, if the price be paid in cash, so much is added to the working capital, thereby enhancing the creditor's security. If the price be not paid, the purchaser's indebtedness may be looked to for the like effect. In either case, there is a tangible asset to which creditors may resort under the forms of law. The directors, who may be aptly styled the trustees, have no right to destroy the fund by giving away the stock, or, which is the same thing, by disposing of it for an insignificant return. Its value in their hands, or rather the value of the creative privilege, is fixed by the charter. When they issue stock to an individual holder, there must be secured to the corporation, in some shape, an equivalent at so much per share, in accordance with the

[1] Shickle *v.* Watts, 94 Mo. 410, 417.

[2] Chouteau *v.* Dean, 7 Mo. App. 214; Kehlor *v.* Lademann, 11 Mo. App. 550.

[3] 7 Mo. App. 210.

fundamental condition of the privilege. It is not now questioned that a corporation may issue its stock by way of payment in the purchase of property. This is on the principle that there is no need for the roundabout process of first issuing the stock for money, and then paying the money for the property. But it is necessary that the property so taken be considered reasonably worth the par value of all of the stock paid for it. The directors have no more right to accept property worth manifestly less than the face value of the stock, than they have to take depreciated or counterfeit currency as an equivalent on the same face value. These principles are alike applicable to the purchase of services with an issue of stock. Many cases are reported in which shareholders held 'full paid' stock, but, because the corporation had received no valuable or lawful consideration for the issue, the owner was held, in favor of creditors, to all the responsibility of a subscriber who is in arrear for the unpaid stock. There is no reason why a like rule should not be applied, according to circumstances, to the case of a gross disproportion between the face value of the stock and the consideration paid for it.'' [1]

§ **1672. Missouri Decisions Further Considered.** — Equally emphatic is the language of the other decision of the St. Louis Court of Appeals upon which the Supreme Court of Missouri thus set its seal of approval. In that case the transaction was in substance an issue of three hundred and forty shares of the capital stock of a corporation, the nominal value of which was $34,000, for the sum, paid by the stockholder, of $33,955.45. And the court, making a strict application of the rule, — held that a creditor of the corporation was authorized to charge the sharetaker for the unpaid balance, although it was only $44.55. The court said: "Between the corporation and the stockholder the contract may be effectual. But creditors have a right to claim that, for every share issued to him, the stockholder shall render the assets its par equivalent, in money or in property, or shall be responsible to the creditors, in certain contingencies, for whatever may be lacking to make up such equivalent. Where property is taken for the stock, it must be at a fair valuation. Where money is taken, or its equivalent, in the discharge of a debt, it must be on the basis of dollar for dollar.'' [2] The law of Missouri on this subject has always been administered in the courts of that State in such a way that no manipulation on the part of the corporate managers can extricate a case from this salutary rule. In a leading case, where certain persons became

[1] Chouteau *v.* Dean, 7 Mo. App. 210, 214; opinion by Lewis, P. J.

[2] Kehlor *v.* Lademann, 11 Mo. App. 550, 555.

stockholders of a corporation with the understanding that the calls were not to exceed a certain per cent., and afterwards calls were made in excess of that amount, and to compensate the stockholders for the payment of this excess second mortgage bonds were issued to them, they were held liable to the creditors of the corporation as for unpaid stock, to the extent of the amount realized by the sale of these bonds.[1] This decision is explicitly opposed to the decision of the Supreme Court of the United States on which we are commenting. It rests upon the principle that it is beyond the power of a corporation to issue its shares at less than their par or nominal value, and that if it does so, and is obliged to assess its shareholders to an extent beyond the amount which was agreed to be the limit of the assessability of the shares, and issues its bonds to re-imburse them, they must account for what they have received for the bonds. It involves a total repudiation of the doctrine of "bonus shares," or that a corporation can under any circumstances give away its potential capital stock, in whole or in part. The decision of the Supreme Court of Missouri, cited by the Supreme Court of the United States in the case on which we are commenting, as evidence of the law of Missouri,[2] affords no support to the conclusion at which the Supreme Court of the United States arrive, but contains a distinct recognition of the principle that corporate shares must be paid for in money or in money's worth. What the Missouri court held in that case was that, under the circumstances surrounding a corporation created for carrying out the great public enterprise, the spanning of the Mississippi river with a bridge, it was competent for the corporation to issue its shares to the extent of $25,000, upon a contract that $5,000 of the amount should be paid for in newspaper advertising, — it being necessary to resort to this means of bringing the enterprise to the attention of the public in order that it might be made to succeed. The decision proceeds upon the ground that such an engagement is not opposed to public policy, and that the shares were in fact paid for in money's worth.[3]

§ 1673. As Shown by a Decision of the Supreme Court of Iowa. — In the other decision of the Supreme Court of the United States before referred to[4] the Supreme Court of Iowa decided the contrary in a case involving this identical transaction, holding that one who took some of the shares of a corporation under the circumstances under which Greene took them, was liable to pay up the unpaid balance of

[1] Skrainka *v.* Allen, 7 Mo. App. 434; affirmed on this question, 76 Mo. 384, 387.

[2] Liebke *v.* Knapp, 79 Mo. 22; *s. c.* 49 Am. Rep. 212.

[3] *Ante*, §§ 1648, 1649.

[4] *Ante*, § 1666.

eighty per cent. for the benefit of creditors of the corporation.[1] The Supreme Court of the United States not only make the extraordinary ruling above stated, but they decline to follow the State court, and they decline to follow it on the general and loose declaration that to follow it would not be consistent with their deliberate judgment "upon this question of general law." Now, nothing is better settled than that the question of the liability of shareholders is not a question of general law.[2] This railroad company was created by the legislature of Iowa, either under a special charter or under a general statute, it is immaterial which. All its powers and all the rights of its shareholders, and all their immunities, and all the incidents attaching to its shares are deducible from the statute law of the State of Iowa. It is perfectly settled that if a court of Illinois or a court of Missouri is called upon to deal with the liability of a shareholder of a corporation created and existing under the laws of Iowa, that liability will be determined by the laws of Iowa. Upon what principle can the Federal courts get above the rule which is binding upon the State courts? In the case of Jackson *v.* Traer, already mentioned, which opinion we have taken the pains to re-read, the Supreme Court of Iowa — it is true by a divided court, three judges against two — in the most deliberate manner, hold that the shareholders of the construction company who got these shares at twenty cents on the dollar are obliged to pay them up for the benefit of the creditors of the railroad company; and they place their holding expressly upon the statute law of the State of Iowa, which statutes they set out in their opinion. If there is any "general law" which in the Federal courts can override this statute law of Iowa, we want to know what "general law" it is, and what is the source of it. Certainly the statute law of Iowa is superior to the common law of Iowa; and if the statute law of Iowa is superior to the common law of Iowa, it is for stronger reasons superior, within the State of Iowa, to the common law of any other sovereignty or jurisdiction. What "general law," in this instance, can override the statute law of Iowa? Is it the "general law" of the United States? It has no general law. Is it the general law of England? What lawyer will dream of such a thing? Is it the general law of Illinois or Missouri or Nebraska? Must such a question be put to lawyers? Then it must be that "general law," and that alone, which consists of the reasoning of the justices of the Supreme Court of the United States. The point is,

[1] Jackson *v.* Traer, 64 Iowa, 483; *s. c.* 52 Am. Rep. 449. See also Boulton &c. Co. *v.* Mills, 78 Iowa, 460; Tama Co. *v.* Hopkins, 79 Iowa, 653.

[2] The Supreme Court of the United States so held in Smith Purifier Co. *v.* McGroarty, 136 U. S. 241; following on a similar question Rouse *v.* Merchants' Bank, 136 U. S. 241, "as decisive of the law of Ohio upon this subject."

from what source does the Supreme Court of the United States get its jurisdiction to override a decision of the Supreme Court of Iowa in the interpretation and application of its own statute law, that law not being opposed to the Federal constitution or to any Federal statute or treaty? If this decision is correct, then we have the spectacle of two kinds of law in the same State, whenever the State and the Federal tribunals differ in their conclusions; and not only this but two kinds of law in the interpretation of local statutes as well as in the general principles of jurisprudence, and this without any power in either tribunal to reverse the other and to settle the law one way. It is intolerable that such a state of things should exist. If the Supreme Court of the United States is not bound to follow the interpretation which the Supreme Court of Iowa puts upon its own statutes, then, by parity of reasoning, it ought to have the power, and it ought to exercise the power, of issuing a writ of error to that court and of reversing its erroneous decisions. But suppose it had undertaken to do this in the case of Jackson *v.* Traer, from what source would its jurisdiction to do this have been derived? But more: if the Federal judiciary can create a "general law" for the people of the United States, the Federal legislature can repeal that law; for it is almost axiomatic that whatever law the judicial branch of a government can *make*, the legislative branch can *unmake*. But if Congress should pass a statute declaring that, in the absence of State constitutions, statutes, or judicial decisions to the contrary, it should be a rule of decision in the courts of the United States that a corporation created by a State cannot give away its unissued shares although they are worthless at the time, from what grant of power in the Federal constitution would it derive its authority? And if Congress cannot legislate upon such a subject, how can the Federal judiciary legislate upon it?

§ 1674. Statutory Exceptions to the Foregoing Doctrine. — A statute of Minnesota,[1] relating to *mining corporations*, apparently concocted by stock brokers to promote their peculiar species of rascality, provides in substance, that the stock of such a corporation "may be issued, sold, and transferred as may be prescribed by resolution or by-laws of said corporation, or its managing board; but no stock so issued or sold, purporting to be fully paid, shall be subject to further assessment in the hands of the lawful holder, without his consent." Under this statute, in the absence of fraud, the creditors of such a corporation have no recourse against the purchasers or holders of stock issued as paid up, for the difference between the par value and the price at

[1] Gen. St. Minn. 1874, c. 34.

which it was sold.[1] Under a similar statute of California the acceptance of stock in a mining corporation, as such corporations are usually formed in California, does not create any obligation to pay to the corporation or to its creditors the nominal par value of the stock so accepted.[2]

§ 1675. View that Rule not Applicable to Subsequent Creditors with Notice. — One case is met with which puts forth the view that where a corporation whose stock is not fully paid, issues full paid certificates to its shareholders, creditors who are such *before the issue of such certificates* may, if the company be insolvent, collect the portion of such stock which was unpaid and have it applied in payment of their debts, but creditors who become such after and with notice of the corporate proceedings by which the stock was made "full-paid" have no such right.[3] And the Supreme Court of Minnesota puts the question upon the principle of *estoppel*, in holding that where stock is issued as fully paid up, without having been paid for to the full amount, shareholders are liable for the amount not actually paid, in favor of creditors giving credit in reliance upon its professed capital having been fully paid in, but not in favor of creditors who dealt with full knowledge that the stock was fictitiously issued as paid up.[4]

§ 1676. Nor to any Person who Gives Credit with Knowledge of the Manner in which Payment has been Made or Secured. — A broader statement of this doctrine is this: As between the company and its stockholders, whatever is agreed to be payment is payment, because both are estopped by their agreement; [5] and that one who becomes the creditor of a corporation knowing the manner in which its stock has been paid or payment therefor secured, is deemed to waive his right to have strict payment made for his benefit.[6] And there is a more general view that it is only *future creditors* who can set aside such an arrangement as to payment.[7]

[1] Ross *v.* Kelly, 36 Minn. 38; *s. c. sub nom.* Ross *v.* Silver & Copper Island Min. Co., 29 N. W. Rep. 591.

[2] Re South Mountain &c. Mining Co., 7 Sawy. (U. S.) 30.

[3] Kenton Furnace &c. Co. *v.* M'Alpin, 5 Fed. Rep. 751.

[4] Deadwood First Nat. Bank *v.* Gustin-Minerva &c. Co., 42 Minn. 327; *s. c.* 6 L. R. A. 676; 7 Rail. & Corp. L. J. 175; 44 N. W. Rep. 198.

[5] Scoville *v.* Thayer, 105 U. S. 153.

[6] Callanan *v.* Windsor, 78 Iowa, 193; *s. c.* 42 N. W. Rep. 652.

[7] Flinn *v.* Bagley, 7 Fed. Rep. 785; *post,* §§ 2091, 2935, 2936.

ARTICLE V. RIGHTS OF BONA FIDE PURCHASERS OF UNPAID SHARES.

§ 1680. Status of Bona Fide Purchasers of So-called "Paid-up Shares." — Where a corporation issues shares as paid-up, treats them as such, and as such, puts them on the market, the certificates stating that they are paid up, a person who innocently purchases them, under the belief that they are paid up, will not be chargeable with liability to the creditors of the company in case the representations of the company that the shares are paid up, should turn out to be false. Such a person is not required to suspect fraud and to institute inquiries where all seems fair and conformable to the requirements of the law. The corporation has no remedy against him *ex contractu*, for it is estopped by its own contract; it has no remedy against him *ex delicto*, for he has done no wrong. Its remedy is against the guilty perpetrators of the fraud.[1]

§ 1681. Protected although the Certificates do not Recite "Paid up." — Some of the courts have carried the principle so far as to hold that where shares of corporate stock are issued as paid up shares, an innocent purchaser of the same, who takes them in good faith as paid up, in the absence of any circumstance to put him upon inquiry, and when the books of the corporation would give no notice that the stock was not paid up, is not liable to creditors of the corporation for the amount unpaid; nor is it necessary in such a case, the certificates being in the usual form,

[1] Waterhouse *v.* Jamieson, L. R. 2 Sc. App. 29; McCraken *v.* McIntyre, 1 Duval (Canada), 479; Foreman *v.* Bigelow, 4 Cliff. (U. S.) 508; *s. c.* 18 Nat. Bank. Reg. 457; 7 Cent. L. J. 430; Brant *v.* Ehler, 59 Md. 1; Phelan *v.* Hazard, 5 Dill. (U. S.) 45; *Re* British Farmers &c. R. Co. 7 Ch. Div. 533; *s. c.* affirmed in H. L. *sub nom.* Burkinshaw *v.* Nichols, 26 Week Rep. 819.

that, in order that they should be regarded as paid up in the hands of an innocent purchaser, they should state on their face that they were fully paid up.[1] The qualification that there is nothing on the books of the corporation to apprise one that the shares are not paid up is very necessary to vindicate these holdings; otherwise all that the subscriber who might become sick of his bargain would have to do in order to pay for his shares would be to sell them, — not to an insolvent or to a sham purchaser,[2] but to any who did not know in point of fact that they were not paid up.

§ 1682. **Unsoundness of this View.**—If the governing statute prohibited the corporation from issuing its share cer-

[1] Keystone Bridge Co. *v.* McCluney, 8 Mo. App. 496; cited and referred to by the Supreme Court of Missouri in Skrainka *v.* Allen, 76 Mo. 384, 392. See also Erskine *v.* Loewenstein, 11 Mo. App. 595; West Nashville Planing Mill Co. *v.* Nashville Sav. Bank, 86 Tenn. 252; *s. c.* 6 Am. St. Rep. 835; 6 S. W. Rep. 340. Compare Sturges *v.* Stetson, 1 Biss. (U. S.) 246; *s. c.* 10 Myer Fed. Dec., § 149. In the case first cited the St. Louis Court of Appeals relied on Foreman *v.* Bigelow, 4 Cliff. (U. S.) 508. Bakewell, J., in giving the opinion of the court, said: "Mr. Shepley, of counsel for the appellant here, stated, in the argument before us, that he had been at pains to ascertain the form of the certificate before the court in Foreman *v.* Bigelow (4 Cliff. (U. S.) 508) and that it was in the usual form, and in the form in the case at bar, nothing being said on the certificate itself as to the stock being paid up. It is believed that a share of stock in the ordinary form would be taken to be paid up in the absence of anything appearing to the contrary, and that it can make no difference whether the certificate says on its face that the stock is fully paid or says nothing about it. We think that where the stock is taken in good faith as paid up, in the absence of anything which should have put the purchaser on his guard, and in a case where the books of the company would have given no notice that the stock was not paid, the purchaser in good faith ought not to be held liable to the creditors of the company. This is the view taken in the well considered case just cited. We know of no contrary ruling, and it is accepted as the correct doctrine by the learned author of the recently issued treatise on Stockholders. Thomp. Stock., § 135. And it does seem that any other rule would not only impose upon the stockholder the duty of examination where he has no means of getting accurate information; but, as was urged before the House of Lords in Burkinshaw *v.* Nicholls, H. L. 3 App. Cas. 1004, and as is said by Lord Chancellor Cairns, delivering the opinion in that case, would tend to discredit and depreciate all stocks and deal a serious blow at the business of manufacturing and mercantile companies." Keystone Bridge Co. *v.* McCluney, 8 Mo. App. 496, 501.

[2] *Post*, § 3255, *et seq.*

tificates until all assessments are paid up, or if the general and recognized custom of corporations were not to issue such certificatess until the shares were fully paid for,— there would be some basis in reason for the doctrine of the preceding section; for then persons dealing in corporate shares would ordinarily assume that they were non-assessable unless the contrary were stated on the face of the certificates. But such not being in general the requirements of the statute law, and the well-known practice of corporations being to issue their share certificates to their subscribers before they have paid more than the first deposit or installment,— it is difficult to uphold the foregoing rule on any just conception. Why a so-called *bona fide* purchaser should be protected in inferring from such a certificate what business men of experience know is an unwarrantable inference, does not and cannot be made to appear. This distinction was recognized by an eminent judge in a case where a railroad company issued its stock to a contractor as full paid shares for building its entire road, and where the purchasers of such shares in the market, as full paid shares, without notice of any equities between the company and such contractor, were held entitled to be protected as purchasers of fully paid up stock, in a suit against them by a judgment creditor of the railroad company.[1] The ground on which the liability on the part of the holders of the stock was placed, was that, in point of fact, none of the shares issued to the contractor were ever paid for; that he received in the company's bonds more in value than the work he performed under his contract; and that, not having completed his contract, the shares, though issued to him, must be treated as not paid for. Dillon, J., said: "The rights and obligations of a *bona fide* transferee of shares purporting to be full paid shares, are different from the rights and obligations of the transferee of shares which do not purport to be full paid. In cases where the certificates show on their face that the shares have been paid in part only, the law implies a promise by the transferee to pay the balance due upon the shares upon calls, when he has come into privity with the company. Such an implied promise rests upon the reasonable and obvious ground, that the

[1] Steacy *v.* Little Rock R. Co., 5 Dill. (U. S.) 348.

transferee has, knowingly and voluntarily, assumed the liability of the transferor. But upon what ground can the law raise a promise to pay the balance due upon shares when the company has asserted, and the purchaser acts upon the assurance, that the shares have been fully paid? The question here urged by the complainants is settled by the universal practice of business men, as well as by the judgments of the courts. Millions of dollars of stocks are sold in this country every week, and there is no practice on the part of purchasers, and no understanding that the law requires of them that they shall ascertain, *aliunde* the representations of the company's authorized officers, that certificates of full paid stock have, in fact, been fully paid. * * * Besides, on what principle is it that a purchaser of the company's shares is to be held to be the guardian of the rights of the company's creditors, and bound to protect them?"[1]

§ **1683. Illustrations of the Rule.**— A Scotch company whose *nominal* capital was £105,000 announced that £100,000 had been paid up, and that only £5,000 could be called for. Relying upon this representation, a gentleman, resident in London, purchased, as a transferee, 300 shares, and paid his proportion of the outstanding £5,000 to the company. The liquidator alleged that this gentleman knew, or *ought* to have known, that the company was a bubble, and proposed to make a call upon him of £30 for each of his shares. The House of Lords (reversing the decree below) held that the liquidator was wrong, the shareholder having done all that could be legitimately demanded of him under his contract.[2] - - - - In a Canadian case, certain shares in a company incorporated by letters-patent issued under 27 & 28 Vict. c. 23, were allotted, by a resolution passed at a special general meeting of the shareholders, to themselves, in proportion to the number of shares held by them at that time, at forty per cent. discount deducted from their nominal value, and scrip was issued for them as fully paid up. G., under this arrangement, was allotted nine shares, which were subsequently assigned to the defendant, for value, as fully paid up. The defendant inquired of the secretary of the company, who also informed him that they were fully paid up shares, and he accepted them in good faith as such, and about a year afterwards became a director in the company. The shares appeared as fully paid up on the certificates of

[1] *Ibid.* 373–4.

[2] Waterhouse *v.* Jamieson, L. R. 2 H. L. (Sc.) 29.

transfer, whilst on each counterfoil in the share-book the amount mentioned was, "Shares, two at $300 = $600." The Supreme Court of Canada held (reversing the judgment of the Court of Appeals for Ontario) that the defendant, having purchased the shares in good faith, without notice, from an original holder under the 27 & 28 Vict. c. 23, as shares fully paid up, was not liable to an execution creditor of the company, whose execution had been returned *nulla bona*, for the amount unpaid upon the shares.[1] - - - - In a case in the United States Supreme Court certain shares in a mining company were issued, as fully paid-up shares, in exchange for mineral lands. The lands were worth far less than the nominal value of the shares, and the transaction was clearly fraudulent. But it was formal and regular on its face; the books of the company showed that the shares were fully paid for; and there was nothing to apprise an innocent purchaser that such was not the fact and nothing to put him on inquiry. Some of these shares were innocently purchased by the defendants, in open market. The company becoming bankrupt, its assignee filed a bill in equity against the defendants, setting out these facts, and praying for an account of the extent to which their shares of stock had been paid for, and the manner of payment. The court held that the bill must be dismissed. "Innocent purchasers of shares are not liable in such a case, but the remedy of the corporation is against the guilty perpetrators of the fraud, in their individual capacity."[2]

§ 1684. Illustrations Continued. — The doctrine already explained, that shares may be paid for in "money or in money's worth," led to such abuses that the Parliament of Great Britain inserted in the Companies Act 1887 the following provision: "Sec. 25. Every share in any company shall be deemed and taken to have been issued and to be held subject to the payment of the whole amount thereof in cash, unless the same shall have been otherwise determined by a contract duly made in writing and filed with the registrar of joint stock companies at or before the issue of such shares." The construction of this statute, in respect of the question we are considering, came before the English Chancery Division in a case which was taken to the House of Lords. A company issued certificates of shares as fully paid up, when in fact no payment had been made, nor contract registered, under the provisions of the companies act of 1867, section 25. At the date of the winding up of the company, some of these shares were held by N., who had no

[1] McCracken *v.* McIntyre, 1 Duv. (Can.) 479.

[2] Foreman *v.* Bigelow, 4 Cliff. (U. S.) 508; *s. c.* 7 Cent. L. J. 430. Similarly, see Du Pont *v.* Tilden, 42 Fed. Rep. 87; *s. c.* 8 Rail. & Corp. L. J. 28.

notice that they were not fully paid up. It was held (reversing the decision of Hall, vice-chancellor) that by the issue of the certificates the company were estopped from alleging that the shares were not paid up, and that N. could not be placed on the list of contributories in respect of them as unpaid shares. An appeal was taken by the liquidator, and the appeal was dismissed by the House of Lords. In giving judgment, Lord Cairns, after quoting the statute, said: "The effect of the section is very simple. Before the passing of the act it was open to any holder of shares to say, 'I have made a contract that I shall not be called on to pay up the value of these shares,' but the abuse of such contracts led to a statutory provision, making it a condition that no shares be treated as fully paid unless their value is paid in cash, or unless publicity is insured by a written contract duly filed in the manner provided for. If Goulton had been called upon to pay up the value of his shares, this section would have deprived him of any defense; but we have now to consider the case of a *bona fide transfer for value*, and I want to know how the section can affect such a transaction. It leaves untouched the question of payment, and says nothing as to evidence of payment; *but if the company gives a receipt for the amount of the shares, and this receipt passes to a purchaser who does not know that no actual payment has been made, his title must not be prejudiced by the statute.* He receives a representation to the effect that the law has been complied with, and it would paralyze the whole trade in companies' shares if a person taking shares with a representation that they are fully paid up must disregard this assertion and satisfy himself of the fact by personal inquiry, especially as he might have considerable difficulty in obtaining accurate information as to the fact of payment or non-payment. Much was said as to the burden of proof and as to the necessity for showing an absence of notice. If the shares come, in the regular course of business, into the hands of a purchaser for valuable consideration, those who challenge the transaction must prove that such purchaser had notice of the fact." Lords Hatherley, Selbourne and Blackburn each gave opinions in concurrence, and Lord Gordon concurred without delivering a separate opinion.[1] - - - - In a leading American case, it appeared that, under a valid contract made by a railroad company for the construction of its road, the company issued shares of its stock to the contractor as full paid shares, and said shares were sold in the public market to purchasers for value without notice of the facts connected with the issue of the shares. It was held that creditors of the company, on its becoming insolvent, could not hold the pur-

[1] Re British Farmers &c. Co., L. R. 7 Ch. 533; *s. c.* affirmed in H. L. 26 Week. Rep. 819; *sub nom.* Burkinshaw *v.* Nicholls.

chasers of said shares liable on the shares as unpaid, on the ground that the contractor had abandoned his contract, and had never done sufficient work to pay for the shares. "It is our judgment," said Dillon, J., "especially in view of the provisions of sections 17, 19 and 29 of the company's charter before adverted to, that shares of stock issued as full paid shares by authority of the board of directors under the construction contract, which was never questioned by the company, or its shareholders or creditors, and which is not assailed or impeached by the pleadings in the cause, and sold by the contractor as full paid shares to purchasers for value without actual notice of the equities between the contractor and the company, if any there be, cannot be held subject to such equities, and to a liability to have shares thus issued and thus purchased treated as unpaid stock. No case holding such a doctrine was referred to by the learned counsel for the complainants, and it is confidently believed that no such judgment has ever been pronounced. It is difficult to perceive any principle of reason or law on which such a judgment could rest. The company has the power to issue its shares. It cannot, without special authority from the legislature, issue its shares as full paid without actual payment in money, or, at least, in money's worth. A leading object of the creation of corporations and the issue of shares is that the shares may be transferred with all practicable facility.[1] The company's directors and officers are the guardians of the company's rights. They ought not to issue shares in violation of their duty. They know whether the shares have been paid for or not. This the public have no means of knowing, and no effectual means for ascertaining. If the company's directors or other authorized officers commit a fraud upon the company in this respect, they are undoubtedly liable therefor. But can any one point out wherein the equities of the creditor of a company thus defrauded by its officers are superior to the equities of those who have acted upon the representations of such officers within the scope of their powers, accredited by resolutions of the directors and authenticated by the corporate seal, and upon such solemn assurances purchased the shares of the company? Grant that the capital stock is a trust fund for the benefit of creditors, yet this trust cannot be followed, any more than other trusts, into the hands of *bona fide* purchasers for value.[2] What contract did the defendants Atkins and Converse make? They made a contract to buy, and did buy, what the company had issued and represented to be full paid shares, without notice that this representation was untrue. If the representation thus made is

[1] Citing Bank *v.* Lanier, 11 Wall. (U. S.) 369; New York &c. R. Co. *v.* Schuyler, 34 N. Y. 30, 82.

[2] Citing Swayne, J., in Sanger *v.* Upton, 91 U. S. 56, 60.

true, they are under no liability again to pay for the shares. If the shares had been represented to have been unpaid, *non constat* that they would have purchased them. Clearly, the *company* would be estopped to make the claim here advanced by its creditors. Again, we ask, in what consists the superior equity of the creditor over the obvious equities which exist in favor of such a purchaser of the company's shares? The creditor trusted that the company's officers would not violate their duty; the purchaser trusted that they had not violated their duty." [1]

§ 1685. **Otherwise, a Subsequent Purchaser with Notice.** — But where property has been conveyed to the company in payment of shares of its stock, at a gross or fraudulent over-valuation, a subsequent purchaser of the shares, with notice of the facts, is liable to creditors of the corporation, to the same extent as the original subscriber.[2]

§ 1686. **When Record of Deed not Notice.** — The record of a deed of real estate to a corporation, reciting that the consideration is a certain number of paid-up shares of the stock, does not constitute constructive notice to creditors that the subscriptions to such shares have been paid in.[3]

§ 1687. **Surrender of Unpaid Shares and Re-issue to Bona Fide Subscriber.** — While devices by which shareholders are released of the liability which they have assumed are almost universally set aside by the courts,[4] yet they will not go so far as to hold that where shares, which have not been paid for, have been issued to a shareholder as "paid-up" shares, and he has thereafter surrendered them to the corporation, and the corporation has re-issued them to a *bona fide* holder, — one who *subsequently* becomes a creditor of the corporation can, in the event of its subsequent insolvency, hold the original shareholder to the liability assumed by his contract or imposed upon him by statute. By such a surrender and re-issue of the shares, the assets of the corporation have been in nowise diminished or impaired, and no element of estoppel enters into such a case.[5]

1 Steacy *v.* Little Rock &c. R. Co., 5 Dillon (U. S.), 348.

2 Boulton Carbon Co. *v.* Mills, 78 Iowa, 460; *s. c.* 5 L. R. A. 649; 43 N. W. Rep. 290.

3 Osgood *v.* King, 42 Iowa, 478.

4 *Ante*, § 1511, *et seq.*

5 Erskine *v.* Peck, 13 Mo. App. 280; *s. c.* affirmed, 83 Mo. 465.

Article VI. Miscellaneous Holdings.

§ 1691. Statutes and Constitutional Provisions on the Subject. — A recent statute of Minnesota prohibits the issuing of false, part-paid and unpaid shares of the stock of railroad companies, under penalty of fine and imprisonment in the State penitentiary, or both.[1] Why such a statute should be confined to railroad companies, leaving the rule in regard to mining companies, elsewhere referred to,[2] in force, is a mystery. - - - - The statute of Florida, providing for corporations, etc., has been amended in respect of the division of capital stock into shares,[3] payment of shares, etc. - - - - An original issue of shares in a corporation at less than one half their par value, on credit, is in violation of the constitution of Alabama.[4] - - - - Under the provision of the constitution of Colorado[5] which declares that no corporation shall issue stock except for labor done, services performed, or money or property actually received, and that all fictitious increase of stock shall be void, persons to whom stock is issued, for which they do not pay or agree to pay anything, do not thereby become shareholders of the corporation in any sense, and cannot sue as such.[6]

§ 1692. Right to Vote before Shares Paid For. — Unless the charter, governing statute, or a valid constating instrument otherwise provides, a subscriber to stock, to whom regular certificates therefor have been issued, is a *bona fide* stockholder, entitled to transfer his stock and to vote at elections, although he has paid nothing for his stock.[7]

[1] Minn. Gen. L. 1887, c. 12, p. 68.

[2] *Ante*, § 1674.

[3] Fla. Laws, 1889, p. 127.

[4] Ala. Const. Art. 14, § 6; Perry *v.* Tuscaloosa Cotton-Seed Oil Mill Co. 93 Ala. 364; *s. c.* 9 South. Rep. 217; 33 Am. & Eng. Corp. Cas. 346.

[5] Const. Colo., Art. 15, § 9; embodied in Gen. St. Colo., §§ 251, 340, relating to corporations.

[6] Arkansas River Land &c. Co. *v.* Farmers' &c. Co., 13 Colo. 587; *s. c.* 22 Pac. Rep. 954.

[7] Downing *v.* Potts, 23 N. J. L. 66.

§ 1693. Time of Payment. — Where the officers of a corporation have no power to give an indefinite extension of time for payment for shares, one with whom they contract for such credit is chargeable with knowledge of the limitations upon their authority, and he cannot maintain an action to enforce such a contract while it remains executory.[1] Where the charter of a bank reserved to the State the privilege of subscribing to a certain portion of the stock, "to be paid for at such time or times as might be convenient for the State," it was held that it was optional with the State to pay at any time before the termination of the charter.[2]

§ 1694. Place of Payment. — *Notice* to pay installments of a subscription to a treasurer of a company implies that the payment is to be made at his office, and is a sufficient designation of the place of payment.[3] Where an act of incorporation requires that the place of payment of stock shall be designated in the notice requiring payment, a *notice* directing payment to be made to A. B., residing in the city of D., is *prima facie* a compliance with the statute.[4]

§ 1695. Index to Cases Turning on Peculiar Circumstances. — Non-liability of stockholders in California mining corporations to pay even the nominal value of their stock.[5] - - - - A complicated state of facts under which it was held that the plaintiff had no right of action for the value of certain shares in a telephone company *consolidated* with another, and that the transaction could not be considered as a *loan* of stock by the plaintiff to the company to be paid for in specie, nor as a *sale* by him of stock to the company at its reasonable value.[6] - - - - Effect of a sale of property to the corporation by a holder of unpaid shares, and of a credit given on the shares, and also upon other shares of the vendor held by the other person as collateral security.[7] - - - - Right of action as creditor of the corporation

[1] McComb *v.* Credit Mobilier, 13 Phila. (Pa.) 468.

[2] Attorney-General *v.* State Bank, 1 Dev. & B. Eq. (N. C.) 545.

[3] Muskingum Valley Turnpike *v.* Ward, 13 Ohio, 120.

[4] Troy Turnpike &c. Co. *v.* M'Chesney, 21 Wend. (N. Y.) 296.

[5] Re South Mountain Consolidated Mining Co., 8 Sawy. (U. S.) 366; *s. c.* 14 Fed. Rep. 347.

[6] Eldred *v.* Bell Tel. Co., 119 U. S. 513; *s. c.* 30 Lawyers' ed. 496; 7 Sup. Ct. Rep. 296.

[7] Craig *v.* Hyde, 24 How. Pr. (N. Y.) 313.

under a statute, by one stockholder against another, where there has been a fund raised by the stockholder under a vote of the corporation for discharging its debts, to which the defendant has fully paid his proportion.[1] - - - - Evidence tending to prove an agreement, in a case where A., as mortgagee, had sold certain property to B., and a corporation had been substituted in the place of B., — that the corporation would accept from B. his interest in the property and pay all incumbrances thereon held by A., thereby making the stock issued to B. paid-up stock, and protecting the holder thereafter from personal liability for debts of the corporation.[2] - - - - A manufacturing company was incorporated with a capital stock divided into shares of $50 each, to consist of one thousand shares, with power to increase the number of shares to three thousand. The act of incorporation authorized the payment of subscriptions of stock in real or personal estate appropriate to the corporate business, at a *bona fide* cash valuation, to be agreed upon by a majority in interest of the subscribers and stockholders. The articles of association provided that the capital should be $140,000, divided into two thousand eight hundred shares of $50 each, and that the subscribers should give their notes without interest for the amounts subscribed by them respectively, which notes should not be liable at any time to an assessment for more than fifty per cent. of their face, nor to an assessment of more than twenty per cent. within eighteen months after the organization of the company. It was held that the legal import of this section was that, with ultimate relation to creditors, the capital was of the full residuary amount of $140,000, but that such calls for payments on stock as might from time to time be made by the corporate authorities, in the course of active business of the company as a solvent concern, should not exceed one-half that amount; and that the articles of association did not exempt the stockholders from liability to creditors for so much of the whole capital of $140,000 as might be necessary for the payment of the debts. The notes of the stockholders, when given, having contained the unauthorized condition that, in the event of the company declaring any dividends out of the profits, the same should be credited on the notes until the full amount of the notes should be paid, when paid up certificates should be issued for the same, it was held that, so far as creditors were concerned, the articles of association could not be altered by this insertion.[3] - - - - The provisions in the charter of an insurance company required it to take security for its stock to the amount of $100,000. It was held that this provision simply required a certain

[1] Fowler *v.* Robinson, 31 Me. 189.

[2] Weber *v.* Fickey, 52 Md. 500.

[3] Wilbur *v.* Stockholders of the Corporation, 18 N. B. R. 178.

amount of cash or secured capital before it commenced business, and after it had that amount it could dispose of its stock upon such terms as it might deem best, as upon a partial payment of twenty per cent., the remaining eighty per cent. to be paid at some future time.[1]

§ 1696. Issuing Unsubscribed Stock at Par where it is Worth More. — An effort on the part of directors and officers of a corporation to obtain unsubscribed stock at par, when they know that each share of the stock already issued is worth several times its face value, is a fraud upon the rights of the other stockholders, and a flagrant violation of trust.[2]

§ 1697. Construction of Particular Charter. — A charter provided "that the capital stock of the company shall consist of five thousand shares of $100 each, of which the lands and mines of" the four persons named, "on one part, and those who may associate with them and constitute the aforesaid subscription for stock, payable in money, on the other part." It was held that this did not provide that any given amount or portion of the stock should be in land or in money, the true construction being that the whole of it may have been payable in money, although the four persons named had conferred upon them the privilege of paying their shares of stock by the conveyance of land, such conveyance, however, not being imposed upon them as an obligation. The land was purchased from two of the principal subscribers by the company, at a valuation which was applicable to their subscriptions. They would be liable to the company for the balance of their stock, as would the balance of the stockholders for the whole amount of theirs.[3]

[1] Upton *v.* Hansbrough, 3 Biss. (U. S.) 417.

[2] Arkansas Valley Agri. Soc. *v.* Eicholtz, 45 Kan. 164; *s. c.* 25 Pac. Rep. 613; 9 Rail. & Corp. L. J. 94.

[3] Frost *v.* Frostburg Coal Co., 24 How. (U. S.) 278.

CHAPTER XXVII.

ASSESSMENTS AND CALLS.

Article I. In General.

§ **1700. What are Assessments, and What not.**— Assessments, as understood in such contracts, are said to mean a rating by the board of directors, by installments, of which notice is to be given. After notice has been given, and the period for payment has passed, an action will lie for the aggre-

gate amount.[1] But these, although generally made by the board of directors, under power conferred on them by the governing statute or the by-laws, can sometimes only be made by the members in a general corporate meeting.[2] Where a stockholder orally agrees to accept such drafts as the corporation shall draw upon him for calls in respect of his stock, and the corporation makes its draft upon him to the order of B., and delivers the same to B. for value, this is not an assignment of the sum due from the stockholder to the corporation. The court say: "The mere drawing and delivery of a bill of exchange is not a transfer of the debt due to the drawer by the drawee. The object of drawing a bill is to convert a supposed indebtedness of the drawee to the drawer, into a chattel that may pass from hand to hand by indorsement and delivery, and this object is defeated when the drawee does not accept; and the recourse of the payee is then upon the drawer."[3]

§ 1701. Power in the Corporation to Make. — The power in the corporation to make assessments upon its shareholders is incidental to the power to raise a joint stock. It arises out of and rests upon the contracts of subscription made under such a statutory power, and, in some cases under statutes which empower the corporation to assess its shares beyond the nominal value thereof where the exigencies of the company require it. Cases are rare in which the power of a joint-stock corporation to assess its shareholders who have not paid for their shares in full has been contested; the contest has generally related to the propriety of making the particular assessment, or of enforcing it against the particular shareholder.

§ 1702. When an Assessment Necessary to a Right of Action. — The *general rule* no doubt is that, in order to maintain an action at law to recover on a contract to subscribe to the stock of a corporation, there must be a call or assessment, or something standing in the place of it and equivalent thereto,

[1] Spangler *v.* Indiana &c. R. Co., 21 Ill. 276.

[2] *Post*, § 1715.

[3] Bank of Commerce *v.* Bogy, 9 Mo. App. 334. See also Bank of Commerce *v.* Bogy, 44 Mo. 14; *s. c.* 100 Am. Dec. 247.

either by the company or by a proper court, in order to make the defendant liable.[1] But, as in the case of *notice*,[2] so an assessment may or may not be necessary to a right of action for the amount which the subscriber expressly or impliedly agrees to pay, or for a part of it, according to the terms of the charter, the governing statute, the by-laws, or the contract of subscription. It is usual, however, in these instruments to provide that the amount subscribed shall be payable when called by the directors, and in many cases limitations are imposed as to the amount which can be called for at any one time, and as to the frequency of the calls. Where such a provision enters into the contract, no action can be maintained against the subscriber on his contract of subscription until a *valid* assessment has been made,[3] except for the purpose of paying the debts of the corporation after insolvency.[4] In other cases the calls must be clearly proved, and the recovery is limited to the amount which has been called.[5] It has been so held, where the terms of the contract of subscription were that the subscriber would pay "all charges and assessments regularly levied or assessed."[6] Nor did the fact that, notwithstanding the terms of the subscription, the subscriber paid the full price for his stock, establish his liability to pay in like manner for the rest; nor was it evidence of an agreement on his part to pay without call.[7]

§ **1703. When Not Necessary.**—As a general rule, where the corporation has ceased to be a going concern and gone into

[1] Chandler *v.* Siddle, 3 Dill. (U. S.) 477.

[2] *Post*, § 1747.

[3] Parton *v.* New Orleans &c. Co., 3 La. An. 19; Chandler *v.* Siddle, 10 Bankr. Reg. 236; Hasley Fire Engine Co. *v.* Donovan, 57 Mich. 318; Grosse Isle Hotel Co. *v.* l'Anson, 43 N. J. L. 442; Bouton *v.* Dry Dock Co., 4 E. D. Smith (N. Y.), 420 (under § 7 of N. Y. act relating to stage companies); Williams *v.* Taylor, 120 N. Y. 244; *s. c.* 30 N. Y. State Rep. 646.

[4] *Post*, § 1703.

[5] South Georgia &c. R. Co. *v.* Ayres, 56 Ga. 230.

[6] Grosse Isle Hotel Co. *v.* l'Anson, 43 N. J. L. 442; affg. *s. c.* 42 N. J. L. 10.

[7] *Ibid.* In this case A. subscribed to stock, stating that he took the number of shares opposite his name, and agreed to pay all assessments to be made by the directors. It was shown that the only assessments the directors were authorized to make were calls of the capital stock. It was held that A. had promised not to pay at once for the whole sum subscribed, but to pay such assessments. Grosse Isle Hotel Co. *v.* l'Anson, 42 N. J. L 10.

liquidation in any form, and the whole amount due by the stockholders is necessary to the payment of creditors, no assessment is necessary.[1] Sometimes, indeed, the court which administers, through its receiver or otherwise, the assets of an insolvent corporation, will ascertain the necessity of a call and will make it by an order of court.[2] Thus, under the law of Georgia, it has been held that where a corporation assigns its property for the benefit of creditors, including unpaid stock subscriptions, and no authority is given the assignees to make calls, the liability of the stockholders does not become absolute, nor does the *statute of limitations* run in their favor until the court of chancery makes a call.[3] Again, in respect of the *deposit*, which is, under many of the charters and schemes of incorporation, required to be paid by the subscriber at the time of making the subscription, we have seen that, according to the best opinion, the failure to pay this at the time of the subscription does not render the subscription void.[4] It follows, on principle, that it remains a *debt* due the corporation payable on *demand*, and that no formal resolution of the board of directors requiring its payment is necessary, but that the bringing of an action for it is a demand. The rule which requires an assessment obviously

[1] Citizens &c. Savings Bank *v.* Gillespie, 115 Pa. St. 564. A call by directors upon stockholders for the balance of their unpaid subscriptions is not essential to the maintenance, after the corporation's insolvency, of a creditor's bill against it and the stockholders, to have their unpaid subscriptions applied in payment of the Bank *v.* Butchers &c. Bank; 107 Mo. 123; *s. c.* 17 S. W. Rep. 644; 28 Am. St. Rep. 405.

[2] Chandler *v.* Siddle, 3 Dill. (U. S.) 477 (U. S. District Court sitting in bankruptcy). An insurance company went into bankruptcy, and, upon application of its assignee, the district court made an order that the balance unpaid upon the capital stock held by the several stockholders should be paid to the assignee on or before a given date; that notice of the order should be given by publication in a newspaper, or otherwise; and that, in default of payment, the assignee should proceed to collect the amount due from each delinquent. The assignee gave notice by publishing the order accordingly, and by mailing a copy, with demand of payment, to each stockholder. It was held that the order of the court was conclusive as to the right of the assignee to bring suit against a delinquent shareholder; that, in point of law, the stockholders were before the court when the order was made, and need not have received actual notice of the order. Sanger *v.* Upton, 91 U. S. 58.

[3] Glenn *v.* Howard, 81 Ga. 383; *s. c.* 8 S. E. Rep. 636.

[4] *Ante*, § 1224; Eastern Plank Road Co. *v.* Vaughan, 20 Barb. (N. Y.) 155.

has no application to the case of an *executory contract* to subscribe for shares in the company. Such a contract is broken when the promisor refuses to make the subscription according to his agreement, and the measure of damages is the difference between the market value of the stock at the time of trial and the amount agreed to be paid for it.[1] Besides, an obligation to pay a certain amount, without any assessment and at all events, may be assumed by the subscribers by contract, if they so choose, in which case the obligation may be enforced without any assessment, and although the amount which they have agreed to pay is larger than the law prescribes for an assessment. Nor will their liability therefor be affected by the danger of misapplication by the corporate agent, by refusal of other subscribers to act with the corporation, by their failure to become members, or by the refusal of the purchasing agents to act.[2] Finally, it has been reasoned that a subscription to the stock of a corporation creates something more than a mere *power* on the part of the corporation to create an indebtedness by making a call on the subscriber, but that it gives a *right* to the stockholder to pay it at once, and he need not wait for a call.[3]

§ 1704. Assessments for Preliminary Expenses. — It has been held that the subscribers for stock, who sign an agreement, after the passing of an act of incorporation, to pay all legal assessments that may be made after the corporation shall be organized, are personally liable for an assessment laid to defray preliminary expenses incurred in obtaining such act, though the corporation was not authorized, at the time of laying such assessment, to lay assessments for the *general objects* of the act.[4]

§ 1705. Power of Directors to Make Assessments. — The directors of a corporation have the power, it is said, even where the governing statute is entirely silent on the subject, to make assessments against the shares of stock of the corporation held

[1] Rhey *v.* Ebensburg &c. Plank Road Co., 27 Pa. St. 261.

[2] West *v.* Crawford, 80 Cal. 19; *s. c.* 21 Pac. Rep. 1123; 26 Am. & Eng. Corp. Cas. 85.

[3] Marsh *v.* Burroughs, 1 Woods (U. S.), 463.

[4] Salem Mill-Dam Corp. *v.* Ropes, 6 Pick. (Mass.) 23; Central Turnpike Corp. *v.* Valentine, 10 Pick. (Mass.) 147. See *ante*, § 416 *et seq.*

by its members.[1] A general statute clothing the directors with the exercise of the powers vested in the corporation, confers upon them this power.[2] But it is doubtful how far it can be affirmed that the directors of a corporation have this power, unless it has been expressly delegated to them by the governing statute, or by the corporation at large, in the form of a by-law, or otherwise. It was held by Mr. Justice Story, at Circuit, that, under the Massachusetts act of 1809, the power to lay assessments was vested exclusively in the corporation, and could not be *delegated* to the directors; [3] nor did a by-law authorizing the directors to "take care of the interests and manage the concerns of the corporation," import an intention to delegate it.[4] This would, however, seem to be an untenable strictness. The directors are the business managers of the company, and the power to call in the subscribed capital of the company as fast as needed would seem to be a corporate power the exercise of which would, by reasonable implication, be regarded as committed to them. As the stockholders cannot conveniently exercise this power in their general meetings, it would at least seem reasonable to imply in them a power to vest it in their directors, by delegation or otherwise.[5] Accordingly, where the charter of an incorporated plank road company authorized *the stockholders* to make calls for payment on subscriptions for stock, and to appoint a board of directors, consisting of stockholders, "to manage the business of the corporation," — it was held that the stockholders might, by resolution, after the organization of the company, delegate

[1] Budd *v.* Multonoma St. R. Co., 15 Ore. 413; *s. c.* 3 Am. St. Rep. 169, 172; citing Cook Stockh. § 109.

[2] It was so held concerning the following statute: "From the first meeting of the directors, the powers vested in the corporation are exercised by them, or by their officers and agents, under their direction, except as otherwise provided in this chapter." Hill Code Ore., § 3225. Budd *v.* Multonoma St. R. Co., 15 Ore. 413; *s. c.* 3 Am. St. Rep. 169, 172. For a useful note on the power of corporation to make calls or assessments upon its stock, and especially the delegation of authority, and the power of courts to make such assessments, collecting American decisions on the subject, see 21 Am. & Eng. Corp. Cas. 631, *n.*

[3] Ex parte Winsor, 3 Story (U. S.) 411.

[4] *Ibid.*

[5] That a requisition for the payment of stock made by the directors of a corporation, under the authority of the by-laws, is binding upon each individual stockholder without his assent, see Smith *v.* Natchez Steamboat Co., 1 How. (Miss.) 479.

to the board of directors the power to call in the stock.[1] But where the power was given *to a corporation*, by the legislature, to raise a fund, in addition to the capital stock, by assessments on the stockholders, it was held that the directors had no power to lay assessments for this purpose, without authority from the corporation.[2] Under any theory the stockholders are above the directors, and unless a mandatory statute fixes the duties of the directors in this respect, the fact that power is conferred upon them to make calls for installments of stock subscribed, does not prevent stockholders, in their articles of association, or in any written contract to pay for stock, from fixing the time of payment; and if such time is fixed by the terms of the subscription, the party subscribing is bound thereby.[3]

§ 1706. Directors Cannot Delegate Power to Ministerial Officers. — But this power, when once vested in the directors, is *discretionary* or *legislative*, in such a sense that they cannot delegate it to subordinate officers of the corporation. The well known rule that delegated power, when discretionary in its nature, cannot be delegated, applies to such a case;[4] although

[1] Rices *v.* Plank Road Co., 30 Ala. 92.

[2] Marlborough Mfg. Co. *v.* Smith, 2 Conn. 579.

[3] Estell *v.* Knightstown &c. Turnp. Co., 41 Ind. 174. In a recent case certain stockholders of a corporation signed an instrument reciting that they had placed 9,000 shares of their paid-up stock in the hands of a trustee, subject to the control of the directors, and that the directors had, with their consent, ordered that 6,000 shares should be sold. These shares were then offered upon the following terms: One-third to be paid down as soon as all the stock was taken, and the remainder to be paid in such installments as the board of trustees should call for it, "for the purposes of the business." The subscribers agreed to pay for their stock according to the terms set forth in the proposal. It was held that it was intended that the calls for installments should be made as the purposes of the business required; that the trustees had no right to call for all at once, unless the purposes of the business so required. Williams *v.* Taylor, 120 N. Y. 244; *s. c.* 24 N. E. Rep. 288; 30 N. Y. St. Rep. 646, reversing *s. c.* 41 Hun (N. Y.), 45; Distinguishing Railroad Co. *v.* Mason, 16 N. Y. 45; Howlands *v.* Edmonds, 24 N. Y. 307; and Tuckerman *v.* Brown, 33 N. Y. 297; *s. c.* 88 Am. Dec. 386.

[4] See *post*, § 3944. The principle is well settled that directors are *prima facie* unable to delegate their discretionary powers even to one or more of their number. Cartmell's Case, L. R. 9 Ch. 691; Howard's Case, L. R. 1 Ch. 561; Ex parte Birmingham Banking Co., L. R. 3 Ch. 651; Cook *v.* Ward, 2 C. P. Div. 255. But this power is often conferred by statute, as in England under the Companies' Act, 1862

cases are found which ignore[1] or evade this salutary principle.[2] Accordingly, where an agreement of subscription to corporate stock provided that subscriptions "should be paid in by installments as may be called by a vote of two-thirds of the board of directors," and the directors *authorized the treasurer* to call for the subscriptions in such installments as might be needed, etc., — it was held that the calls made by the treasurer under this authority were invalid.[3]

§ 1707. Power Limited by the Charter or Governing Statute. — Assuming that the power of the directors has not been enlarged by the contract of the common adventurers among themselves, or so far as affects the rights of any one of them, by his conduct,[4] the general rule is that the power of the directors in respect of the levying of assessments must be sought for in the charter or governing statute.[5] Thus, if the charter confers the power to raise a definite sum, when this sum is raised the power

(Taurine Co., 25 Ch. Div. 118), and under the Companies' Clauses Consolidation Act, 8 and 9 Vict. Ch. 16. See D'Arcy *v.* Tamar R. Co., L. R. 2 Exch. 158; Totterdell *v.* Fareham Brick Co., L. R. 1 C. P. 674. And where the power of delegation exists, its exercise will, under particular circumstances, be presumed. Totterdell *v.* Fareham Brick Co., *supra;* Lyster's Case, L. R. 4 Eq. 233; Ex parte Contract Corporation, L. R. 3 Ch. 105, 116; Lind. Comp., 5th ed., pp. 156, 329, 338.

[1] We find a case in Pennsylvania where this principle was ignored, and where calls made by the *treasurer* under general authority given by the board, were held valid, although the resolutions do not specify the amount of each call. Hays *v.* Pittsburgh &c. R. Co., 38 Pa. St. 81.

[2] See Rutland &c. R. Co. *v.* Thrall, 35 Vt. 536, where a very irregular, and it seems illegal assessment, was worked out and made valid on the theory that the directors might *ratify* the acts of a committee of their members. Compare Pike *v.* Bangor &c. R. Co., 68 Me. 445, where an assessment made by a committee of one, and not ratified by the board, was held void.

[3] Silver Hook Road *v.* Green, 12 R. I., 164.

[4] *Ante,* § 1705. *Post,* § 1877, *et seq.*

[5] In an early case in Nebraska an assessment was levied upon shares of stock in a ferry company, and suit in chancery commenced to subject the shares to the payment of such assessment, although the charter of the company gave it no authority so to do. Service was made by publication, the bill taken *pro confesso,* decree rendered, and the shares sold. It was held: 1. That the decree was *coram non judice,* and void. 2. That the purchaser having procured title to the shares under color of these proceedings, held dividends received thereon in trust for the original owner. Williams *v.* Lowe, 4 Neb. 382.

of assessment is exhausted.[1] So, stock which has been fully *paid up*, cannot be further assessed without special authority conferred by charter or by statute;[2] and moreover this authority, in order to be valid, must obviously have been conferred prior to the subscription, or it would impair the obligation of the contract and be void.[3] Moreover, where the directors possess this power, they must exercise it in accordance with the charter: all the prerequisites of that instrument must be complied with before an action will lie to recover installments.[4]

§ 1708. Statutes Authorizing Assessments of Full Paid Stock. — Under some statutes the shares of corporate stock may be subjected to further assessments, although it has been, so to speak, fully paid up. It has been so held under a statute of Pennsylvania, authorizing corporations to "assess upon each share of stock such sums of money as the corporation may think proper, not exceeding in the whole the amount at which each share was originally limited."[5] It has been so held under certain clauses of the Code of California,[6] providing that, in case of corporations, "no one assessment must exceed ten per cent. of the amount of the capital stock named in the articles of incorporation;" except that (subdivision 1) "if the whole capital of a corporation has not been paid up, and the corporation is unable to meet its liabilities or to satisfy the claims of its creditors, the assessment may be for the full amount unpaid upon the capital stock;" and that "no assessment must be levied while any portion of a previous one remains unpaid, unless the assessment falls within the provisions of subdivision 1; and that, with these exceptions and limitations, corporations may levy assess-

[1] State *v.* Morristown Fire Assoc. 23 N. J. L. 195. See next section.

[2] Great Falls &c. R. Co. *v.* Copp, 38 N. H. 124; Atlantic &c. Co. *v.* Mason, 5 R. I. 463.

[3] *Post*, § 3032.

[4] Barret *v.* Alton &c. R. Co., 13 Ill. 504. Where the charter of a company authorizes a call and assessment on unpaid shares of stock only in case of "losses exceeding the means of the corporation," this clause does not limit the right of the company so created to make an assessment for the payment of *losses only*. When the funds are exhausted by losses and an assessment becomes necessary, it may be made *for all purposes*, either to pay debts already contracted or to create a new fund for the purpose of a business basis. *Re* Republic Ins. Co. 3 Biss. (U. S.) 457.

[5] Price's Appeal, 106 Pa. St. 421.

[6] 1 Cal. Code, §§ 332, 333.

ments upon the subscribed capital stock" for corporate purposes.[1]

§ 1709. Statutes Restraining the Power to Assess. — Statutes exist restraining the power of assessment, in some cases making it depend upon a *vote of the stockholders*. The effect of such statutes where the rights of creditors are involved, will be considered hereafter.[2] In a Federal case the general law under which the corporation was organized declared: "No stockholder shall ever be held liable or responsible for the contracts or faults of such corporation in any further sum than the unpaid balance due to the company on the shares owned by him." The charter prescribed in what installments forty per cent. of the stock should be paid, and then declared: "The balance on each share, or any portion of such balance, shall not be called for, unless with the assent of three-fourths of the stockholders, and then only to increase the business of the corporation." It was held that, after the payment of forty per cent. of his stock, no stockholder was liable for the balance, unless it had been called for by a vote of three-fourths of the stockholders.[3]

§ 1710. Stockholders cannot Question the Necessity for the Call. — Assuming that the directors are vested with the discretionary power of making assessments, and that the exercise of the power by them is not specially restrained, the wisdom or necessity of making them is exclusively for their determination, and is not open to question by the stockholders in the judicial courts,[4] in the absence of fraud.[5]

[1] Santa Cruz R. Co. *v.* Spreckles, 65 Cal. 193.

[2] *Post*, § 3537.

[3] Louisiana Paper Co. *v.* Waples, 3 Woods (U. S.), 34.

[4] Budd *v.* Multonoma Street R. Co., 15 Ore. 413; *s. c.* 3 Am. St. Rep. 169, 172; 15 Pac. Rep. 659; Chouteau Ins. Co. *v.* Floyd, 74 Mo. 286; Judah *v.* American Livestock Assn., 4 Ind. 333.

[5] In an action against a corporation, wherein the declaration alleged that, in order to carry out a scheme of fraud, an unnecessary assessment was levied, but did not allege that the assessment was in excess of the powers of the directors, — it was held that, as to the wisdom or necessity of an assessment or the motives which prompted it, the court would not inquire. Oglesby *v.* Attrill, 105 U. S. 605. See also Bailey *v.* Birkenhead &c. R. Co., 12 Beav. 443.

§ 1711. Assessments Authorized under Particular Statutes.— An assessment by an electric light company for necessary repair of its engine and other machinery, without which it would be unable to answer the demands upon it for the supply of electric light, is authorized by the California statute[1] providing for the levy of assessments for the purpose of "paying expenses, conducting business or paying debts."[2] - - - - Where a mining corporation bought an adjoining property and transferred all the property to a new corporation, receiving stock in the new corporation therefor, and borrowed money from one of its stockholders to pay the expenses thereof, there being no fraud, the company was liable for the money borrowed, and could levy an assessment to pay for it.[3]

§ 1712. After a Resolution to Discontinue Business.—The adoption by a corporation of a resolution to discontinue business, does not operate as a *dissolution*, in such a sense as to deprive the corporation of the power to enforce assessments upon stock by actions against its stockholders.[4]

§ 1713. Illegality of one Assessment will not Vitiate Subsequent Legal Assessment. — It has been laid down, in an action for calls, that the illegality of one assessment, — in the particular case, the first assessment, — will not vitiate subsequent assessments or proceedings for the forfeiture and sale of the shares thereunder, nor afford a good defense to an action for the recovery of such subsequent assessments. The reasoning on which this holding proceeds is that each assessment gives a *separate right of action* to the corporation; that the assessments are *severable;* and that, although the corporation brings a single action to recover the entire balance due after the sale of shares under the forfeiture, yet the illegality of the first assessment will not so far vitiate the whole as to prevent a recovery of the amount due under the subsequent assessments.[5]

§ 1714. Periodicity of the Calls: Intervals between Them. —The amount which the directors can call at any one

[1] Cal. Civ. Code, § 331.

[2] Younglove *v.* Steinman, 80 Cal. 375; *s. c.* 22 Pac. Rep. 189.

[3] Taylor *v.* North Star Gold Min. Co., 79 Cal. 285; *s. c.* 21 Pac. Rep. 753.

[4] Chouteau Ins. Co. *v.* Floyd, 74 Mo. 286.

[5] European &c. R. Co. *v.* McLeod, 3 Pugsley (N. B.), 3, 39, 41.

time, the time at which they can make and enforce the call, the intervals which must elapse between the calls, and their power to call in the whole amount at one time,— are all questions depending for their solution upon the governing statute, valid by-laws thereunder, and the terms of the contract of subscription.[1] It has been held that, under a statute[2] which authorizes the directors to require "payments from subscribers to the capital stock of the sums subscribed by them, at such times and in such proportions and on such conditions as they shall see fit,"— the directors are invested with a full discretionary power as to the time and manner of payment. They may require *the whole* subscription to be paid at one time, or in installments.[3] Where the terms of a subscription required that "assessments should not exceed five dollars on each share at one time," it was held, that if no greater sum is payable at one time, the fact that several assessments were *voted at one time* is immaterial.[4] On a similar view, a resolution of the board of directors of a railroad company requiring the payment of ten per cent. every thirty days on all cash subscriptions until the whole subscriptions are paid, has been held evidence of a call for a payment of installments on stock subscribed for in thirty days from its date and every thirty days thereafter.[5] It has been held that when not more than two calls are to be made in any successive twelve months, the period is to be calculated from the date of the first call, so that three calls may be made in thirteen successive months, provided but four be made in two years.[6]

§ 1715. Regularity of Meetings Convened to Make Assessments. — As hereafter seen, a board of directors can only act in the exercise of their discretionary powers, as a body at meet-

[1] Subscribers to stock in a railroad company must pay their subscriptions as the work progresses, such being the *intent of the parties*, as gathered from the nature of the work to be accomplished. McMillan *v.* Maysville, &c. R. Co., 15 B. Mon. (Ky.) 218; *s. c.* 61 Am. Dec. 181.

[2] 1 Gav. & H. Ind. St. 477, § 11.

[3] Haun *v.* Mulberry &c. Gravel Road Co., 33 Ind. 103.

[4] Penobscot R. Co. *v.* Dummer, 40 Me. 172; *s. c.* 63 Am. Dec. 654; Rutland &c. R. Co. *v.* Thrall, 35 Vt. 536. Compare Spangler *v.* Indiana &c. R. Co., 21 Ill. 276.

[5] Heaston *v.* Cincinnati &c. R. Co., 16 Ind. 275; *s. c.* 79 Am. Dec. 430.

[6] Dinkgrave *v.* Vicksburg Co., 10 La. An. 514.

ings regularly convened,[1] and some attention has been given to this subject already.[2] If a meeting of the *stockholders* convened to make an assessment upon stock is a special or *called* meeting, it can only be convened upon *notice* duly given to the stockholders, stating the object of the meeting.[3] It has been held that neither a clause in the charter declaring that "all or any business of the corporation may be transacted, or acted on," at such a meeting, nor a by-law, passed in pursuance of the charter, prescribing how notice of special meeting shall be served upon the stockholders, can dispense with the necessity of specifying, in such a case, the purpose in the notice of the meeting.[4] Some of the statutes are so minute as to prescribe the manner in which meetings shall be held at which assessments shall be voted. Such a statute exists in Colorado in regard to mining companies. Under its provisions, assessments on stock require a vote of the stockholders at a meeting held at the principal office of the company, to be held not less than thirty days from the publication of such call; notice thereof, signed by the president or secretary, is given to the stockholders, stating the object, time and place of the meeting, and is published in the county where the operations are carried on, weekly, for four consecutive weeks, and in a paper of general circulation where the principal office is, daily, for thirty days, the last publication being ten days before the meeting. Notice is also served personally on or mailed to each stockholder. If, at such meeting, a majority favor it, the directors or trustees shall make the assessments.[5]

§ 1716. **Interest on Assessments.** — Whether interest is payable upon calls will depend upon the provisions of the particular statutes,[6] and if these are silent, upon the provisions of the general statutory law in regard to the accruing of interest. The

[1] *Post*, § 3932.

[2] *Ante*, § 706.

[3] *Ante*, § 707.

[4] Mason *v.* Atlantic &c. Co., 5 R. I. 463. That a finding that a meeting of directors of a corporation was "duly and regularly convened," and that an assessment made thereat was "lawfully and rightfully levied," includes a finding that the necessary notice was given, see Younglove *v.* Steinman, 80 Cal. 375; *s. c.* 22 Pac. Rep. 189.

[5] Gen. Stat. Colo. 1883, chap. 19, § 86.

[6] See the provisions of the English statutes collected in Lind. Comp. 5th ed. 414.

general principle is that interest begins to run from the time when the call *ought to be paid*, and not from its date.[1] While it is not, as a general rule, competent for the directors to pay *interest on shares;*[2] yet if a member pays in his subscription before it becomes due according to the terms of the contract — that is to say, before it is called — and the directors have agreed to pay interest on it as so much money advanced to the company, they must pay this interest, although there may be no profits out of which to pay it. The reason is that the payment of interest, under such circumstances, is not a reduction of the capital, but an expenditure of the general assets in the payment of a lawful debt.[3]

§ 1717. Action to Recover Back Money Paid on an Assessment. — It is well known that an action at law lies to recover back money voluntarily paid under a mistake of fact;[4] but no such action lies to recover back money voluntarily paid under a mere mistake of law, unmixed with any circumstances of fraud, imposition or undue influence;[5] nor will an action lie to recover money voluntarily paid without fraud, imposition, duress, or undue influence, and with full knowledge of all of the facts.[6] If,

[1] Johnson *v.* Lyttles Iron Agency, 5 Ch. Div. 687. Interest not recoverable upon calls for the non-payment of which the shares have been forfeited: Stockton's Case, L. R. 5 Eq. 6; *s. c.* L. R. 3 Ch. 412. Under a Virginia statute (Va. code of 1873, c. 57, Sec. 23), a stockholder in a corporation is liable for interest from the *date of the call* on him for an assessment to meet corporate liabilities. Hawkins *v.* Glenn, 131 U. S. 319; *s. c.* 9 Sup. Ct. Rep. 739. An act of incorporation authorizing the company to charge five per cent. interest per month on all stock subscribed and not paid within thirty days, created was a *penalty*, and not merely interest. Custar *v.* Titusville Gas &c. Co., 63 Pa. St. 381.

[2] *Post*, § 2236.

[3] Dale *v.* Martin, 11 L. R. Ir. 371; affirming *s. c.* 9 L. R. Ir. 498.

[4] Yeates *v.* Hines, 24 Mo. App. 619; Morrow *v.* Surber, 97 Mo. 155; Ellis *v.* Ohio &c. Co., 4 Oh. St. 628; *s. c.* 64 Am. Dec. 610; Rheel *v.* Hicks, 25 N. Y. 291.

[5] Lowry *v.* Bourdieu, Doug. 471; Bilbie *v.* Lumley, 2 East, 469; Stevens *v.* Lynch, 12 *Id.* 38; Brisbane *v.* Danes, 5 Taunt. 144; Mowatt *v.* Wright, 1 Wend. (N. Y.) 355; *s. c.* 19 Am. Dec. 508; Norton *v.* Marden, 15 Me. 45; *s. c.* 22 Am. Dec. 132: Morton *v.* Ludlow, 1 Edw. Ch. 643. *Contra,* Culbreath *v.* Culbreath, 7. Ga. 64; *s. c.* 50 Am. Dec. 375.

[6] Morris *v.* Turin, 3 Dall. (Pa.) 147; *s. c.* 1 Am. Dec. 233; Bulkley *v.* Stewart, 1 Day (Conn.) 130; *s. c.* 2 Am. Dec. 57; Hall *v.* Shultz, 4 Johns. (N.

therefore, the stockholders in a corporation, desiring to raise capital to prosecute the venture, assess themselves and pay into the treasury sums beyond what is required by the mere obligation of their subscription, — one of them who subsequently becomes dissatisfied with what he has done, cannot maintain an action against the corporation to recover back what he has thus voluntarily paid in, on the theory that it is a loan.[1]

§ 1718. In the Case of a Corporation Formed from a Partnership.— A recent holding in the Supreme Court of North Dakota is to the effect that a corporation formed from a partnership may assess its capital stock to pay debts incurred by the firm in procuring property which has been transferred to the corporation, so long as the assessment is less upon each person than he was originally required to furnish as a partner, the firm capital not having been actually paid in.[2]

§ 1719. Injunction against the Enforcement of Calls. — It seems that a shareholder may have an injunction to prevent a forfeiture of his shares for non-payment of a call, where the shares are fully paid up, though relief will be confined to restraining proceedings against his shares,[3] or under particular circumstances where he has been inveigled into subscribing through fraud.[4] Where the shares are assessable an injunction will not be granted to restrain the directors from making an assessment on the mere ground that the corporation is *insolvent*, that its affairs have been mismanaged, and that the directors will proceed to forfeit the shares of the plaintiff if the assessment is not paid, — including a prayer for the appointment of a receiver to wind up the corporation, but not charging any breach of trust.[5] Mere *insolvency* is, of course, no ground for restraining the collection of stock subscriptions, but may be a good ground

Y.) 270; Robinson *v.* Charleston, 2 Rich. L. (S. C.) 317; *s. c.* 45 Am. Dec. 739.

[1] Ridwell *v.* Pittsburgh &c. R. Co., 114 Pa. St. 535; *s. c.* 15 Am. & Eng. Corp. Cas. 623; 6 Atl. Rep. 729; 5 Cent. Rep. 287; 11 East. Rep. 421.

[2] Hennessy *v.* Griggs (N. D.) 44 N. W. Rep. 1010.

[3] Moore *v.* New Jersey Lighterage Co., 25 Jones & S. 1 (N. Y. Superior Ct. App.); 5 N. Y. Supp. 192.

[4] *Ante*, § 1424.

[5] Gorman *v.* Guardian Savings Bank, 4 Mo. App. 180.

for enforcing them.[1] Equitable relief cannot, in general, be had on the mere ground of *mistake of law*, — that is, that the subscriber has mistaken the obligations incurred by him under the charter.[2] When a person becomes a corporator in a company he is bound to know the obligations which he thereby incurs.[3] Such obligations are matters of law resulting from the construction of the charter. Whether a subscriber is or is not liable to pay future installments is a question of law arising upon that construction. If both parties are mistaken as to the construction, it is no ground in equity or law for setting aside the obligation of the contract.[4] The mere fact that the directors who are enforcing the calls against other stockholders are not themselves paying their assessments, does not entitle the other stockholders to equitable relief.[5]

§ **1720. Assessments Levied against Original Subscriber after Sale and Repurchase.** — It has been held, under a charter which gave no remedy against members for delinquent assessments except by a sale of their shares, that if an original subscriber sells his shares *bona fide* to a third person, and afterwards repurchases them, and thereafter an assessment is levied against them, — an action can not be maintained against him for such assessment, although the contract of subscription contained a distinct promise to pay the sums which should be assessed on his shares.[6] The court likened the case to that where, after a devise of real estate, the testator sells a part of it, and then repurchases it, in which case the part sold and repurchased will not pass under the will. The decision seems entirely unsound. The opinion proceeds on the assumption that if the defendant had not sold his shares, he would have been liable to pay the amount which, by his contract of subscription, he agreed to pay in respect of them. Upon all the modern holdings this liability followed the assignment of his shares to his assignee, and followed the re-assignment of them by his assignee to him.[7]

§ 1721. Assessments Must be Equal.— A demurrer will be sustained to a complaint in an action against a stockholder to recover

[1] Dill *v*. Wabash &c. R. Co., 21 Ill. 91.

[2] *Ante*, § 1393.

[3] *Ante*, §§ 1136, 1259.

[4] Chesapeake &c. Canal Co. *v*. Dulany, 4 Cranch C. C., (U. S.) 85.

[5] Grant *v*. Attrill, 11 Fed. Rep. 439.

[6] Franklin Glass Co. *v*. Alexander, 2 N. H. 380; *s. c.* 9 Am. Dec. 92

[7] *Post*, § 2335.

an assessment upon the shares of a corporation, which alleges that some of the stockholders have paid 40 per cent. of their subscriptions, and others but 2 per cent., and that a horizontal assessment of 35 per cent. has been made on all shareholders alike,— on the ground that such assessment is unequal and unjust and should not be enforced, even though such assessment was made by the court of another State having jurisdiction.[1]

Article II. Conditions Precedent: Full Subscription — Organization.

§ 1724. When Subscription of Entire Capital a Condition Precedent to a Valid Assessment. — The general rule, supported by the concurrence of most of the courts, is that, where the charter or governing statute fixes the amount of capital which the corporation shall have, and does not authorize it to commence business with a less amount, no assessment can be made upon subscribers until the capital so fixed has been all filled up by *bona fide* subscriptions, unless the subscriber has, by conduct

[1] Great Western Tel. Co. *v.* Burnham, 79 Wis. 47; *s. c.* 9 Rail. & Corp. L. J. 132; 47 N. W. Rep. 373; Bowen *v.* Kuehn, 79 Wis. 53; 47 N. W. 374.

or otherwise *waived* his privilege.[1] This rule varies under particular statutory systems. Thus, in Oregon, after one-half of the capital stock of a private corporation has been subscribed and a board of directors elected, assessments may be made upon the stock thus subscribed.[2]

§ **1725. Illustrations of the Rule.**—Where, by the charter or articles of incorporation of a railroad company, an organization and the election of directors and officers were provided for, upon $100,000 of stock being subscribed, the capital stock being $1,000,000; and where it was further provided that such directors should thereupon re-open the books and continue to receive subscriptions until the whole amount of the capital stock should be subscribed, and that "all subscriptions to the stock of said company shall be paid at such times, in such amounts and on such conditions as said directors may prescribe,"—it was held that the latter provision, respecting the time and terms of payment, had reference to the time when the full amount of the capital stock should have been subscribed, and that an assessment upon the shares of stockholders, ordered to be made before such period, was unauthorized and invalid.[3] - - - - Where the charter or governing

[1] *Ante*, § 1235 *et seq;* Penobscot R. Co. *v.* Dummer, 40 Me. 172; *s. c.* 63 Am. Dec. 654; Penobscot R. Co. *v.* Whittier, 12 Gray (Mass.), 250; Penobscot R. Co. *v.* White, 41 Me. 512; *s. c.* 66 Am. Dec. 257; Read *v.* Memphis &c. Gas Co., 9 Heisk. (Tenn.) 545; New Hampshire &c. R. Co. *v.* Johnson, 30 N. H. 390; *s. c.* 64 Am. Dec. 300; Exposition &c. Co. *v.* Canal Street &c. R. Co., 42 La. An. ; 7 So. Rep. 627; Haskell *v.* Worthington, 94 Mo. 560; Shurtz *v.* Schoolcraft &c. R. Co., 9 Mich. 269 (previous to Mich. Act of 1857); Peoria &c. R. Co. *v.* Preston, 35 Iowa, 115 (many cases are examined); Orynski *v.* Loustaunan, (Tex.) 15 S. W. Rep. 674; Anvil Min. Co. *v.* Sherman, 74 Wis. 226; *s. c.* 4 L. R. A. 232; *s. c.* 5 Rail. & Corp. L. J. 603; 42 N. W. Rep. 226; Bray *v.* Farwell, 81 N. Y. 600; Salem Mill Dam. Corp. *v.* Ropes, 6 Pick. (Mass.) 23 and 9 Pick. (Mass.) 187; *s. c.* 19 Am. Dec. 363; Central Turnpike Corp. *v.* Valentine, 10 Pick. (Mass.) 142; Cabot &c. Bridge *v.* Chapin, 6 Cush. (Mass.) 50; Worcester &c. R. Co. *v.* Hinds, 8 Cush. (Mass.) 110; Stoneham Branch R. Co. *v.* Gould, 2 Gray (Mass.), 277; Oldtown &c. R. Co. *v.* Veazie, 39 Me. 571; Lttletown Man. Co. *v.* Parker, 14 N. H. 543; Contocook Valley R. Co. *v.* Barker, 32 N. H. 363. See 19 Am. & Eng. Corp. Cas. 285, *n.*; 21 *Id.* 305, *n.* In Wordsworth on Joint Stock Companies, it is said: "The amounts of capital mentioned in the statute must have been subscribed before calls upon the shareholders can be made or enforced. In such cases there is a condition precedent to be satisfied before a shareholder can be subjected to an action for a call." Wordsw. Joint Stock Corp. 318.

[2] Astoria &c. R. Co. *v.* Hill, 20 Or. 177; *s. c.* 25 Pac. Rep. 379.

[3] Peoria &c. R. Co. *v.* Preston, 35 Iowa, 115.

statute provides that "no such corporation shall prosecute business with any other than its members until at least one half of its capital stock has been subscribed, and at least twenty per cent. thereof actually paid in,"[1] no action can be maintained by the corporation against a shareholder to recover an assessment, subsequent to the preliminary one determined upon for the organization of the company, without alleging that the above statutory requirement has been complied with. The reason for this conclusion has been thus stated: "Until this statute is complied with, the corporation has no use for or right to such an assessment. It is a condition precedent to such a call or such an assessment, maintaining the reason of the general current of authorities, in the absence of such a statute. The object of the statute seems to be to prevent fictitious and fraudulent corporations from extorting money from confiding stockholders, and obtaining credit when they have no real basis of capital to do business upon and no resources to meet their liabilities. After they have obtained as much money as could be protected from discovery or inquiry from their first subscribers, less than half of the whole number, they may abandon their corporation, and the fraudulent scheme is ended. We think that it is within the intention of this statute that no call or assessment upon the shares of stock already taken, subsequent to the first one for preliminary purposes, shall be made until one full half of the capital stock has been subscribed and 20 per cent. thereof has been actually paid in. It follows, therefore, that the complaint as to the second cause of action ought to have alleged that the plaintiff corporation had complied with this statute, as a condition precedent to its right of recovery."[2]

§1726. Bona Fide Subscriptions Within This Rule. — The rule which requires that subscriptions by which the capital is filled up before a valid assessment can be made shall be *bona fide* subscriptions, intends that they shall be *made in good faith* by the subscriber and accepted in good faith by the commissioners, the promoters, or other persons acting for the intended corporation in receiving such subscriptions. It means that such subscriptions shall be made in good faith, and *not colorably* under some secret arrangement for a rescission, by persons apparently able to pay and to bear equally with the other subscribers the burden assumed.[3]

[1] R. S. Wis., § 1773.

[2] Anvil Mining Co. *v.* Sherman, 74 Wis. 226; *s. c.* 42 N. W. Rep. 226.

[3] Penobscot R. Co. *v.* White, 41 Me. 512; *s. c.* 66 Am. Dec. 257; Lewey's Island R. Co. *v.* Bolton, 48

§ 1727. Where the Charter Fixes the Minimum Amount. — Moreover, it is a general rule, subject to the like exception, that where the charter or governing statute fixes the *minimum amount* of capital which the corporation shall have, and does not authorize it to commence business with a less amount subscribed, but confers upon it the power to raise a larger amount, — no legal assessment upon its subscribers can be made until this minimum amount has been *bona fide* subscribed.[1]

§ 1728. This Condition May be Waived by the Subscriber. — But it has been conceded that such a charter or statutory provision is capable of being *waived* by the subscriber, either by signing an agreement to that effect, or by conduct in subsequently participating in the organization and business of the corporation.[2] The rule does not apply, for manifest reasons, where the shareholder knows of the act of the directors in commencing business before the amount of stock provided for by the articles of association is taken and paid in, and acquiesces in this course of conduct; and in many cases it will appear that the question of the liability of the shareholder is made to turn upon this question of fact, whether or not he did acquiesce in this action of the directors, with knowledge.[3]

§ 1729. Illustration of Such a Waiver. — Thus, in one case a company was organized with a proposed capital of 10,000 shares of £25 each, and the defendant took some of the shares. Directors were chosen, who commenced business and incurred debts when not more than 1400 out of the 10,000 shares had been taken. In a *suit by a creditor* of the company against the defendant as a shareholder and partner, to recover his debt contracted with the directors on behalf of the company, Lord Abinger, C. B., told the jury that, without evidence that the defendant knew and assented to the act of the directors in their carrying on business with a smaller capital than that which was originally

Me. 451; *s. c.* 77 Am. Dec. 237; Penobscot R. Co. *v.* Dummer, 40 Me. 172; *s. c.* 66 Am. Dec. 654; New Hampshire Central Railroad *v.* Johnson, 30 N. H. 390; *s. c.* 64 Am. Dec. 300; Cabot &c. Bridge *v.* Chapin, 6 Cush. (Mass.) 53. Compare *ante*, § 1222.

[1] Oldtown &c. R. Co. *v.* Veazie, 39 Me. 571.

[2] New Hampshire Central Railroad *v.* Johnson, 30 N. H. 390; *s. c.* 64 Am. Dec. 300; Cabot &c. Bridge *v.* Chapin, 6 Cush. (Mass.) 53; Pitchford *v.* Davis, 5 Mees. & W. 2; Bray *v.* Farwell, 81 N. Y. 600 (recognized); *ante*, § 1243.

[3] Pitchford *v.* Davis, *supra*.

proposed, he could not be bound by the contract made by them, and that it was for the jury to say whether the business was so carried on without his knowledge and consent. The jury having, under this direction, found a verdict for the defendant, a motion was made for a new trial and was refused. Lord Abinger, C. B., said: "The question is, whether the directors were the agents of the defendant in carrying on the business with so small a capital. I thought at the trial, and am still of the same opinion, that where a prospectus is issued, and shares collected, for a speculation to be carried on by means of a certain capital to be raised in a certain number of shares, a subscriber is not liable in the first instance, unless the terms of the prospectus in that respect are fulfilled. But if it be shown that he knows that the directors are carrying on the undertaking with a less capital, and have acquiesced in their so doing, he may become answerable for their future contracts." Parke, B., said: "The defendant, by taking shares in this speculation, gives authority to the directors to bind him by their contracts, in the event of the proposed number of shares being disposed of, and the proposed capital obtained. The secretary who gives the order to the tradesman is the party primarily liable; the directors also, who give the order to the secretary may be liable. A third party may become liable, if it can be shown that he has authorized the act of the directors in making the contract. But, by proving the defendant to be an original subscriber, unless the proposed capital is raised, no such authority is shown." Alderson, B., said: "The authority given by the subscribers to the directors is a conditional one, depending on the terms of the prospectus being fulfilled. In this case that condition had not been fulfilled, and therefore the defendant is not bound by the contract of the directors; and the jury have found that he had not ratified the act of the directors, with a knowledge of that condition not having been performed."[1]

§ 1730. Rule Applicable to Joint-Stock Companies in New York. — In like manner, it is held in New York that, in the absence of a provision in the articles of association of a *joint-stock company*, to the effect that the company may proceed to business and levy assessments upon its shareholders upon a partial filling up of its capital, it is necessary, in order to charge an individual subscriber for an assessment before the whole stock is taken, that he has *waived* his right to insist upon that condition, by his own acts.[2]

[1] Pitchford *v.* Davis, 5 Mees. & W. 2.

[2] Bray *v.* Farwell, 81 N. Y. 600.

§ 1731. Illustration. — By the articles of association of a joint-stock company, its capital was fixed at $3,000,000, divided into 30,000 shares. It was provided that the number of shares might be increased or diminished by resolution of the board of directors, and the shares were each made subject to assessment to pay liabilities, etc., which the shareholders agreed to. There was no provision authorizing the commencement of business until the whole capital stock was subscribed for and taken. About 15,000 shares were subscribed for, upon which only $50 per share was required to be paid, for which certificates for full paid stock were issued. Business was commenced and liabilities to the extent of about $450,000, in addition to the amount which had been paid in by the stockholders, were incurred in the space of a single year. To meet these liabilities, the directors determined to make an assessment upon stockholders of $40 per share. The assessment having been made, an action was brought against one who had subscribed for 300 of the shares, to collect the assessment. In this action it was not shown that the defendant ever attended a meeting of the shareholders, or assented in any way to the commencement or prosecution of business before all the shares were taken, or that he knew before the assessment was made that all the shares had not been taken. It was held that he was not bound by the acts of the directors and was not liable; and moreover that, by dealing with his shares of stock as property, he had not incurred the obligation sought to be enforced, or precluded himself from terminating or contesting the assessment.[1]

§ 1732. Rule where the Capital and Number of Shares are Fixed by the Members. — There is judicial authority in favor of the proposition that the rule is the same where the governing statute allows the members to fix the amount of the capital and the number and denomination of the shares,[2] — the rule being that already adverted to,[3] that the person who agrees to take shares in a company with a given capital, is *prima facie* not bound to take shares in a company with a different capital.[4] Moreover, according to some opinion, where the charter of a railroad corporation provides that the capital stock shall consist of not more than a certain number of shares, "the number of

[1] Bray *v.* Farwell, 81 N. Y. 600.

[2] Littleton Man. Co. *v.* Parker, 14 N. H. 543; *s. p.* Contoocook Valley R. Co. *v.* Barker, 32 N. H. 363.

[3] *Ante*, §§ 1235, 1322.

[4] Lind. Comp. 5 ed. 393; citing Bourne *v.* Freeth, 9 Barn. & Cres. 632; Fox *v.* Clifton, 6 Bing. 776; Pitchford *v.* Davis, 5 Mees. & W. 2.

which shall be determined from time to time by the directors thereof," the directors have no power to levy assessments upon subscribers for stock, before determining the number of shares.[1]

§ 1733. No Valid Assessment until Capital and Shares Fixed. — Under this theory, no valid assessment can be laid upon the shares of subscribers to the stock of a corporation, unless the number of the shares of capital stock is definitely fixed, either by the charter, the directors or the stockholders.[2] The theory is that if the charter does not fix the number of shares, it is to be presumed that the legislature intended that the stockholders or the directors should fix the number; and it is indispensable that the number be so determined before any assessment can be made thereon.[3] And if, in such a case, the number of shares so fixed exceeds the number actually subscribed for and taken, the stockholders or directors may change the number; but the assessment must be upon the whole number. If the shares are not all taken, an assessment upon the number that have been taken is void. A subscriber who has paid the first assessment is not thereby estopped from setting up this defense to a suit for the second.[4] But where the charter of a corporation limited the capital stock to not less than 500 nor more than 10,000 shares, of $100 dollars each, and authorized the directors to assess upon 500 shares as soon as subscribed for, and from time to time to enlarge the capital up to the maximum limit, all the shares to be equally assessed, it was not deemed necessary for the corporation to determine the ultimate amount of the capital within the limit of the 10,000 shares, before proceeding to make assessments upon the first 500 subscribed for.[5]

§ 1734. Where the Minimum Amount of the Capital is not Fixed at all.—There is an opposing view that, where the number

[1] Worcester &c. R. Co. *v.* Hinds, 8 Cush. (Mass.) 110; Stoneham Branch R. Co. *v.* Gould, 2 Gray (Mass.), 277; Troy &c. R. Co. *v.* Newton, 8 Gray (Mass.), 596.

[2] Somerset R. Co. *v.* Clark, 61 Me. 379; Pike *v.* Bangor &c. R. Co., 68 Me. 445.

[3] Somerset &c. R. Co. *v.* Cushing, 45 Me. 524.

[4] Somerset &c. R. Co. *v.* Cushing, 45 Me. 524. But compare York &c. R. Co. *v.* Pratt, 40 Me. 447, and next section.

[5] White Mountains Railroad *v.* Eastman, 34 N. H. 124.

of shares is not fixed by the charter or by the agreement of subscription and the subscriber promises to pay for the shares which he takes, his subscription is not deemed to be made upon condition that the whole number of shares constituting the capital stock, according to the *by-laws*, shall be subscribed.[1] Where the charter merely fixes the *maximum amount* of the capital to be raised, and the subscription embodies a definite promise to take and pay for the shares set opposite the respective names of the subscribers at a stated sum per share, the same conclusion follows. Such a case is distinguished from those cases in which a definite capital is fixed, or a definite proportion or sum is required as a condition precedent to organization, or in which conditional subscriptions are made.[2]

§ 1735. An Illustration of the Foregoing. — After the grant of a charter to a railroad company, providing that the capital stock should not exceed 2,000 shares of $100 each, subscriptions were received as follows: "Providence, June, 1873. We, the subscribers, severally agree to and with the Warwick Railroad Company, that we will take the number of shares of one hundred dollars ($100) each, in the capital stock of said company, set opposite our respective names, under the provisions of its charter, and that we will pay for the same in such manner as the board of directors may, under the charter, direct." In an action by the corporation against a defaulting subscriber, it was held: 1. That the contract was good and the subscriber liable, notwithstanding the whole capital was not subscribed for. 2. That the word "share" did not imply a proportion of a definite capital. 3. That subscribing for a share was equivalent to subscribing $100.[3]

§ 1736. The Present Doctrine in England.— Sir Nathaniel Lindley, in the last edition of his work on Companies,[4] thus states the present doctrine in England on this subject, citing the cases in the margin: "Although the whole of a company's intended capital has not been subscribed, it does not follow that those who have subscribed are not bound to furnish funds to enable it to commence operations. If, by a company's special act or charter, the subscription of the whole, or a definite part

[1] Kennebec &c. R. Co. *v.* Jarvis, 34 Me. 360.

[2] Warwick R. Co. *v.* Cady, 11 R. I. 131.

[3] Warwick R. Co. *v.* Cady, 11 R. I. 131.

[4] Lind. Comp. L. 5th ed. 410.

of the proposed capital, is made a condition precedent to the right to require payment of anything from those who have subscribed, effect must be given to such a condition;[1] but there is nothing in any general act now in force having any such effect;[2] and consequently, where there is no special act or charter affecting the question, the liability of a subscriber to a company to contribute to its capital before the whole has been subscribed for, depends entirely upon the contract into which he may have entered; and there are several instances in which persons have been held bound so to contribute, although the whole capital of the company which they had joined had not been subscribed for.[3] *Prima facie*, however, they are not so bound;[4] and in all the cases in which they were held bound, the defendants had entered into a contract which precluded them from maintaining that the subscription of the whole of the originally proposed capital was an express or implied condition to their becoming shareholders.[5] With respect to companies formed under the Companies' Act, 1862, and having no special articles of their own, it is conceived that the directors have power to commence business, and make calls before the whole capital is subscribed for."[6]

§ **1737. Whether Rule Applies to New Stock.** — It has been held that the foregoing principle has no application to the case where an existent corporation issues *new stock* and allows its

[1] Norwich &c. Nav. Co. *v.* Theobald, 1 Moo. & M. 151. And see North Stafford Steel Co. *v.* Ward, L. R. 3 Ex. 172; Pierce *v.* Jersey Waterworks Co., 5 *Id.* 209.

[2] There was a clause to the effect in question in the repealed act relating to banking companies formed after May, 1844. See 7 & 8 Vict. c. 113, § 5.

[3] MacDougall *v.* Jersey Imperial Hotel Co., 2 Hem. & M. 528; Lyon's Case, 35 Beav. 646. See Scottish Petroleum Co., 23 Ch. Div. 422.

[4] See Fox *v.* Clifton, 6 Bing. 776; Pitchford *v.* Davis, 5 Mees. &. W. 2; North Stafford Steel Co. *v.* Ward, L. R. 3 Ex. 172.

[5] See Hutt *v.* Giles, 12 Mees. &. W. 492; Waterford &c. R. Co. *v.* Dalbiac, 6 Ex. 443; London &c. Ass. Co. *v.* Redgrave, 4 C. B. (N. S.) 524; Norman *v.* Mitchell, 5 DeGex. M. & G. 648; *s. c.* 19 Beav. 278.

[6] Ornamental Pyrographic Co. *v.* Brown, 2 Hurl. & C. 63; MacDougall *v.* Jersey Hotel Co., 2 Hem. & M. 528; Lyon's Case, 35 Beav. 646. Howbeach Coal Co. *v.* Teague, 5 Hurl. & N. 151, however contains dicta to the contrary; and see North Stafford Steel Co. *v.* Ward, L. R. 3 Ex. 172, which, however, turned on the articles.

existing stockholders to subscribe for it in proportion to their respective holdings.[1] Thus, where the directors of a *national bank* passed a resolution to *increase its stock*, giving its stockholders the right to take the new stock to an amount equal to that then held by them, the fact that some of the new stock was not taken was not sufficient ground for a particular stockholder to repudiate the new stock taken by him and withdraw the amount paid therefor, nor to exempt him as a shareholder from statutory liability to creditors.[2] Contrary to this, it has been held that the principle that the whole amount of capital fixed by the charter must be subscribed before a valid assessment can be made, also applies in case of an increase of it.[3]

§ 1738. Whether a Condition Precedent Which Corporation must Show. — The theory of the cases first cited[4] is that in an action to recover an assessment laid for the general objects of the corporation, where the charter requires that the capital shall be divided into a certain number of shares, the corporation must show that all the shares were subscribed before the assessment was laid.[5] On the contrary, another court has held that an unconditional subscription for "shares" in the "capital stock" of a body described by a corporate name may be sued without making proof of the incorporation and the subscription of the full amount of stock required by law to due organization. The theory is that such a subscription impliedly admits these facts.[6] On a similar theory, the Supreme Court of Ohio have held that where, in a petition to recover a subscription to the stock of a railroad company, it is averred that the directors have been duly elected by the stockholders, in pursuance of notice, it is to be presumed that the requisite amount of stock has been subscribed to authorize such election, and also to authorize the location of the road and the making of assessments by the directors so elected.[7]

[1] *Post*, § 2103.

[2] Aspinwall *v.* Butler, 133 U. S. 595; *s. c.* 33 L. ed. 779; 10 Sup. Ct. Rep. 417.

[3] Read *v.* Memphis &c. Gas Co., 9 Heisk. (Tenn.) 545.

[4] *Ante*, § 1724.

[5] Central Turnp. Corp. *v.* Valentine, 10 Pick. (Mass.) 142; Salem Mill-Dam Corp. *v.* Ropes, 6 *Id.* 23.

[6] Lail *v.* Mt. Sterling Coal Road Co., 13 Bush (Ky.), 32.

[7] Ashtabula &c. R. Co. *v.* Smith, 15 Ohio St. 328.

§ 1739. Doctrine that Assessments may be Laid before All Shares Taken.— The doctrine already announced [1] has not met with universal acceptance. The view has been taken that calls may be made before all capital stock is subscribed, if so agreed between the corporation and the stockholders, *unless the charter otherwise provides.*[2] The doctrine of these cases is that whenever the corporation is so organized as to be able to prosecute its business, it has, through its board of directors, the power to levy assessments.[3] The Supreme Court of Oregon reason that when a sufficient amount of the capital stock of a private corporation has been subscribed to authorize the stockholders to proceed to the election of directors, after the election thereof assessments may be legally made upon the unpaid stock so subscribed, and this though the corporation has *increased* its capital stock and the entire amount of the shares of the original stock and of the increased stock has not been subscribed. But they concede that it is otherwise where a subscription of the entire number of shares, of the original as well as any contemplated increase of stock, has been made a condition precedent to the exercise of the power of levying assessments.[4] So, it has been held that a stockholder is liable *to creditors* upon his subscription, although all of the capital stock was not taken up.[5] Another court has held that an unconditional promise in a stock subscription to pay for a certain number of shares at par is binding, though the amount of

[1] *Ante*, § 1724.

[2] Cheraw &c. R. Co. *v.* Garland, 14 S. C. 63. That it is not necessary to fix the capital stock to enable a corporation to maintain an action on the subscription agreement, see Bucksport &c. R. Co. *v.* Buck, 65 Me. 536.

[3] This is the doctrine which obtains under the general incorporation laws of Oregon. Willamette Freighting Co. *v.* Stannus, 4 Oreg. 261. That a corporation may receive subscriptions to stock, and may sue thereon, before being *fully organized*, see Oregon &c. R. Co. *v.* Scoggin, 3 Oreg. 161. So, under the Indiana act of 1852, for the incorporation of railroad companies, after the subscription of $50,000 to its stock, the company may call in the subscriptions, without waiting for the subscription of the whole capital stock, as a condition precedent to their right to collect. Hoagland *v.* Cincinnati &c. R. Co., 18 Ind. 452. So, the Supreme Court of the United States has held that the subscription of the *whole* capital stock of $500,000 was not a condition precedent to the putting of the Mechanics' Bank of Alexandria into operation as a corporation. Minor *v.* Mechanics' Bank of Alexandria, 1 Pet. (U. S.) 46.

[4] Willamette Freighting Co. *v.* Stannus, 4 Oreg. 261.

[5] Farnsworth *v.* Robbins, 36 Minn. 369.

capital stock was not fixed, and the *minimum number* of shares *named in the charter* was not subscribed for.[1] The same conclusion has been reached where the corporation was organized under a general law, and the subscription agreement did not contain an express provision that all the stock should be subscribed.[2] In New York a plank-road company might go into operation before the whole nominal amount of its stock was subscribed.[3]

§ 1740. **Further of this View.** — In an action brought against a shareholder to subject so much of his subscription to the capital stock of the corporation as remains unpaid, if it appear that the certificate of incorporation fixed the capital stock at a given sum divided into a given number of shares of a given par value, it will be no defense that the corporation *commenced business with a less sum*, and that the defendant paid in his proportion of such smaller sum; nor that the smaller stake on which the corporation commenced business was not paid in as a subscription to capital stock, but merely as a capital generally, and that it was agreed among those who paid the money that it should be in full of all liability as to them.[4] The reason is, that where the co-adventurers in such a case have become incorporated under a statute, and have published to the world, by their certificate of incorporation, their intended capital, it would operate as a *fraud upon the public* dealing with them, for them to enter into a secret arrangement to carry on business with a smaller capital, and to exonerate the subscribers to their capital from liability for the full amount of their respective subscriptions. "The capital stock of a corporation," say the court, "other than a mining corporation, is the amount of money paid or promised to be paid for the purposes of the corporation. It is a fixed sum, not to be increased or diminished except in the mode permitted by the statute. This sum the law requires shall be stated in the certifi-

[1] Skowhegan &c. R. Co. *v.* Kinsman, 77 Me. 370.

[2] West *v.* Crawford, 80 Cal. 19; *s. c.* 21 Pac. Rep. 1123; 26 Am. & Eng. Corp. Cas. 85.

[3] Schenectady &c. Plank-road Co. *v.* Thatcher, 11 N. Y. 102; Rensselaer &c. Plank-road Co. *v.* Barton, 16 N. Y. 457, note; Hamilton &c. Plank-road Co. *v.* Rice, 7 Barb. (N. Y.) 157.

[4] Thompson *v.* Reno Savings Bank, 19 Nev. 103; *s. c.* 3 Am. St. Rep. 797. See the next section.

cate of incorporation, to be filed with the county clerk of the county in which the principal place of business of the corporation is situated, and a copy in the office of the Secretary of State. The purpose of this requirement is obvious. The shareholders are not, under the constitution, liable for the debts of the corporation. The capital stock, and especially the unpaid subscriptions thereto, is a *trust fund* for the benefit of the general creditors. When, therefore, the law requires a public declaration of the amount of the capital upon which the corporation operates, it contemplates a truthful statement in which the general public dealing with the corporation may confide. The certificate is made for the benefit of the public, not for the corporation or its stockholders. Those who participated in the incorporation of this bank, and, by a certificate made in pursuance of the statute, announced the amount of its capital stock, cannot, as against the creditors of the corporation, contradict their own certificate. Defendant Lake signed it, was president and one of the directors of the bank, participated in the management of its affairs during the period it was engaged in business, and received dividends upon his investment. He cannot now be heard to deny the truth of the certificate which he helped make, and to assert that the capital of the corporation was $30,000, instead of $100,000. Not only will equity refuse to hear the defense interposed, but the arrangement alleged to have been made is in defiance of the statute under which the bank was incorporated. Section 3543 of the compiled laws provides: 'It shall not be lawful for the directors to divide, withdraw, or in any way pay to the stockholders, or any of them, any part of the capital stock, nor to reduce the amount of the same.' "[1] This is a sound and wholesome decision; but it is seemingly opposed to an early decision in New York made before the American doctrine that the assets of a corporation are a trust fund for its creditors became fully established and understood. This decision is to the effect that, where a certificate is filed in the office of the Secretary of State, pursuant to the statute, for the purpose of constituting the subscribers a "body politic and corporate," in which the capital is fixed at a certain sum, the subscribers of

[1] *Ibid.*, opinion by Belknap, C. J.

the certificate are not liable individually to creditors for the difference between the sum specified and the sum actually subscribed; and it is *discretionary* with the company to raise the whole amount of capital mentioned in the certificate or not.[1]

§ 1741. Sufficient Amount not Paid in, in Order to Transact Business. — It is, then, no defense in a proceeding against a stockholder, whether by the company or by one of its creditors to recover in respect of a balance due upon his stock subscription, that, by the terms of its charter, the company was prohibited from commencing business until a prescribed amount of capital stock should be *paid in.* Such a provision, it has been held, was intended for the benefit of those who might deal with the company — not for the benefit of its shareholders as a condition precedent to the right to enforce the collection of calls duly made upon stock subscribed.[2] Indeed, the contrary construction would be absurd; for then, recusant stockholders could, by their very recusancy, prevent the company from acquiring the necessary paid up capital to commence business, and thereby defeat their own contracts made with it.

§ 1742. Rule under Particular Statutes. — The preceding sections suggest that this rule is varied under particular statutes of incorporation. Thus, under the general statutes of Ohio relating to railroad companies, when *ten per cent.* of the capital stock of such a company has been subscribed, and the corporation has been fully organized, assessments upon the stock subscriptions may be made and enforced, although the whole amount of such stock, mentioned in the certificate of incorporation, may not have been subscribed.[3] And the same rule has been applied under the general laws of Kansas relating to corporations, in respect of a bridge company.[4] It is needless to say that, where a railroad corporation is authorized by its charter to begin the construction of its road whenever a given number of shares has been subscribed for, it can assess its shares when the subscriptions have reached that number, although the whole number of shares has

[1] Brinckerhoff *v.* Brown, 7 Johns. Ch. (N. Y.) 217. Affg. *s. c.* 4 Johns. Ch. (N. Y.) 671.

[2] McDermott *v.* Donegan, 44 Mo. 85; Naugatuck Water Co. *v.* Nichols, 58 Conn. 403; *s. c.* 8 L. R. A. 637; 20 Atl. Rep. 375. See also Sims *v.* Brooklyn Street R. Co., 37 Ohio St. 556.

[3] Jewett *v.* Valley R. Co., 34 Ohio St. 601.

[4] Hunt *v.* Kansas &c. Bridge Co., 11 Kan. 412.

not been determined;[1] and of course the same rule applies relatively in the case of any other corporation.

§ 1743. Where an Organization is a Condition Precedent. — But it remains that where the act of incorporation contemplates some act to be done, as *organizing* the company before installments of stock can be required to be paid, such act must be done before the corporation can maintain an action for the installments, the subscription being made prior to the time of organization.[2]

Article III. Sufficiency and Notification of the Assessment.

§ 1746. Form, Substance, Language of the Call. — In respect of the form in which the board of directors choose to couch the assessment or call, it is not necessary that the resolution adopted by them should show that the call is made for any corporate purpose, or that it should show that the demands of the business of the corporation require that the subscriptions to its capital stock should be paid. All that is necessary is that there should be some act or resolution which evinces a clear official intent to render due and payable a part or all of the unpaid subscription.[3] If a call leaves the date at which it is to be paid in blank, it will be invalid until another resolution is passed fixing the date, and the curative resolution will not relate back to the former one.[4] An omission to make a *record* of a call for

[1] Boston &c. R. Co. *v.* Wellington, 113 Mass. 79.

[2] Carlisle *v.* Cahawba &c. R. Co., 4 Ala. 70; Anvil Mining Co. *v.* Sherman, 74 Wis. 226; *s. c.* 42 N. W. Rep. 226.

[3] Budd *v.* Multonoma Street R. Co., 15 Ore. 413; *s. c.* 3 Am. St. Rep. 169, 172; citing Cook Stock, § 115.

[4] Re Cawley, 42 Ch. Div. 209; *s. c.* 31 Am. & Eng. Corp. Cas. 425.

a particular installment is supplied by the record of a call for *all other* unpaid installments.[1] Where a corporation was limited to fifteen per cent. calls per annum, and ten per cent. had already been called,— it was held immaterial that the last call did not specify the amount, time or place of payment, the accompanying *notice* pointing out the time and place.[2]

§ 1747. **When Demand or Notice Necessary.**— Whether it is necessary for the corporation to give to the subscriber a *notice* to pay his assessment before it can maintain an action to recover the same, would seem to depend upon the language of the charter, the governing statute, the by-laws, or the contract of subscription. If the law of the corporation, whatever it be, requires a notice as a condition precedent to such an action, and there is no waiver of the condition, of course the notice must be given.[3] Thus, if the charter expressly requires notice to be given in certain *newspapers*, and for a certain number of days, before the calls for installments shall be valid, the company must show a compliance with such condition precedent, before a recovery can be had on such calls.[4] So, if, by the terms of the contract of subscription, the subscription is payable upon *twenty days' notice*, the plaintiffs, in order to recover, must prove, in the first instance, not only that they gave notice, but that they gave it twenty days before bringing suit.[5]

§ 1748. **When not Necessary.** — On the other hand, if there is no such provision, and if the subscription has been accepted by the corporation, so that the contract has become complete and the subscriber has become a stockholder, a *notice* is not indispensably necessary to the right of the corporation to maintain the action, but the general rule of law applies, that the bringing

[1] Hays *v.* Pittsburgh &c. R. Co., 38 Pa. St. 81.

[2] Andrews *v.* Ohio &c. R. Co., 14 Ind. 169.

[3] Heaston *v.* Cincinnati &c. R. Co., 16 Ind. 275; *s. c.* 79 Am. Dec. 430, 434. See Alabama &c. R. Co. *v.* Rawley, 9 Fla. 508.

[4] Macon &c. R. Co. *v.* Vason, 57 Ga. 314.

[5] Cole *v.* Joliet Opera House Co., 79 Ill. 96. A statute (N. J. Rev., p. 926, § 7), providing that the directors may require subscriptions to be paid "in such installments as they may deem proper," imports that a subscription does not fall due until *notice* of a call therefor made by the directors. Braddock *v.* Philadelphia &c. R. Co., 45 N. J. L. 363.

of the action is itself a *demand*.[1] It has been broadly reasoned that a contract to pay for stock in installments as assessed, is a contract to pay them on demand, and the bringing of a suit is a sufficient demand;[2] from which it of course follows that no notice of the call, by publication or otherwise, is necessary.[3] And where, by the terms of the contract of subscription, the times of payment of the installments are fixed, of course there is no necessity for a demand before bringing suit.[4] And where the subscription was to the stock of a railroad company, and the subscribers, by the terms of the contract, stipulated to pay the first installment after the work should be commenced, "as shall hereafter be directed by the directors of said company," and there was no stipulation for notice to the subscribers of the calling in of the installment, it was held that no proof of notice or demand, other than an order passed as above, by the directors, and entered on the record book, was necessary, in a suit against a subscriber to recover said installment.[5] Nor is the corporation compelled, if it have two remedies, one by *forfeiture* and the other by suit, to give notice to the defendant before suit brought against him, of which one it intends to avail itself.[6]

§ 1749. **Theory that no Notice is Necessary except to Forfeit.** — In early Pennsylvania cases the doctrine is found, seem-

[1] New Albany &c. R. Co. *v.* McCormick, 10 Ind. 499; *s. c.* 71 Am. Dec. 337; Ross *v.* Lafayette &c. Co., 6 Ind. 297; Johnson *v.* Crawfordsville &c. R. Co., 11 Ind. 284; Smith *v.* Indiana &c. R. Co., 12 Ind. 61, 64; Eakright *v.* Logansport &c. R. Co., 13 Ind. 408; Brownlee *v.* Ohio &c. R. Co., 18 Ind. 72; Beckner *v.* Riverside &c. Turnp. Co., 65 Ind. 470; Miller *v.* Wild Cat Gravel Co., 52 Ind. 51; Estell *v.* Knightstown &c. Co., 41 Ind. 174; Wilson *v.* Wills Valley R. Co., 33 Ga. 466; Eppes *v.* Mississippi &c. R. Co., 35 Ala. 33; Van Riper *v.* American Central Ins. Co., 60 Ind. 123. Haun *v.* Mulberry &c. Co., 33 Ind. 1034. The Indiana cases hold that the stockholder is neither entitled to a notice of the assessment nor of the time and place of payment.

[2] Smith *v.* Indiana &c. R. Co., 12 Ind. 61; Eakright *v.* Indiana &c. R. Co., 13 Ind. 404; Breedlove *v.* Martinsville &c. R. Co., 12 Ind. 114.

[3] Beckner *v.* Riverside &c. Turnpike Co., 55 Ind. 468.

[4] New Albany &c. R. Co. *v.* Pickens, 5 Ind. 247.

[5] Ross *v.* Lafayette &c. R. Co., 6 Ind. 297.

[6] New Albany &c. R. Co. *v.* Pickens, 5 Ind. 247. A statute of this State (1 Gav. & H. 507, § 8), authorizing *notice* to be given of calls for payment by installments of stock subscriptions, has been held to apply only to subscriptions *in money*. Ohio &c. R. Co. *v.* Cramer, 23 Ind. 490.

ingly ignoring the provisions of the statute, that notice is not necessary in order to the liability of the subscriber for the *assessments*, though it may be necessary in order to make him liable for the *penalty* prescribed for the non-payment of the same.[1] This theory, as adopted and more distinctly stated in Indiana, is that where the charter requires notice, as a condition precedent to suits for installments on stock, and there is no waiver of this condition, notice, as thus required, must be given before an action can be maintained against the stockholder.[2] But where the statute[3] requires notice or a personal demand thirty days before a proceeding to *forfeit the stock*, but not before *suit* to recover installments, it is held that the subscribers must take notice of the action of the directors as to assessments.[4] But, under a statute of Maryland, the necessity of a demand or notice is not confined to cases where the corporation is proceeding for the forfeiture of the stock; but the demand or notice is a condition precedent to the right of the corporation to sue for assessments on the stock.[5]

§ 1750. Comments on this Doctrine: The English Doctrine Stated. — The doctrine of the two preceding sections, that the man who subscribes to the stock of a corporation and agrees to pay his subscription when it is called for by the corporation or its directors, can be put in default and subjected to the costs and expenses of a lawsuit when a call is made of which he has no notice, either actual or constructive, had its origin in Pennsylvania and Indiana in the beginning of the era of railroads, when the decisions of those courts (and of some others) were so grossly partial to the railroad companies that they scarcely deserve to be cited at all. They afford infamous illustrations of the extent to which the rights of the individual were overridden out of complacency to the corporation. On the subject under

[1] Gray *v.* Monongahela Nav. Co., 2 Watts & S. (Pa.) 156; *s. c.* 37 Am. Dec. 500, 504; cited with approval in Grubb. *v.* Mahoning Nav. Co., 14 Pa. St. 305.

[2] Compare *ante*, § 1332, *et seq.*

[3] Here, the general railroad law of Indiana.

[4] Heaston *v.* Cincinnati &c. R. Co., 16 Ind. 275; *s. c.* 79 Am. Dec. 430. See also Smith *v.* Indiana &c. Co., 12 Ind. 61; Johnson *v.* Crawfordsville &c. Co., 11 Ind. 280; Hill *v.* Nisbet, 100 Ind. 356.

[5] Scarlett *v.* Academy of Music, 43 Md. 203.

consideration, the English rule agrees with the doctrine of those American courts which hold that a *demand* prior to the bringing of the action, or what is the same thing, a *notice* of the call, is essential to the right of action, unless the contract or the governing statute, or a valid by-law dispenses with it. The English rule is thus stated by Sir Nathaniel Lindley,[1] citing the cases in the margin: "Inasmuch as a call is to be considered as made when a resolution that it be made is duly passed, and inasmuch as it would be unjust to any person liable to pay a call to treat him as in default unless he has had notice of the making of a call, it is held that such notice must be given to him before he can be dealt with as a defaulter; and this rule applies not only where notice is expressly required to be given by the company's act, charter, or deed of settlement, but also where there is no express provision upon the subject, and the shareholder has entered into an absolute covenant to pay such calls as may be made.[2] Indeed, in one case it was said, that the notice made the call;[3] but this is not in conformity with the rule now established."[4]

§ **1751. English Holdings as to the Form of the Notice and the Mode of Giving It.** — Sir Nathaniel Lindley[5] thus concludes the decisions in that country as to the form of the notice and the mode of giving it: "The notice to be valid must be in such form, if any, as may be required by the regulations of the company; and where a notice is required to be signed by the directors, it will not be sufficient if their signatures are affixed by a clerk.[6] A notice requiring payment to the account of a person at a particular bank, is equivalent to a notice to pay to that person.[7] A list of persons prepared by a deceased clerk whose business it was to send the notices, and ticked or marked

[1] Lind. Comp. L., 5th ed., 417.

[2] Miles *v.* Bough, 3 Ad. & El. (N. S.) 845. See, too, Edinburgh &c. R. Co. *v.* Hebblewhite, 6 Mees. & W. 707; Painter *v.* Liverpool Gas Co., 3 Ad. & El. 433; and as to cost-book companies, 32 & 33 Vict. c. 19, § 10.

[3] Shaw *v.* Rowley, 6 Mees. & W. 810.

[4] Stratford &c. R. Co. *v.* Stratton, 2 Barn. & Ad. 518.

[5] Lind. Comp. L., 5th ed., 418.

[6] See Miles *v.* Bough, 3 Ad. & El. (N. S.) 845.

[7] *Ibid.* But see The Leeds Banking Co., L. R. 1 Ch. 150.

by him so as to show that notices were sent to the persons on the list, is admissible in evidence to prove that a notice was sent to them.[1] The notice must be given in the manner required by the act or regulations applicable to each particular company."[2] The learned author then recites the provisions of a number of statutes as to this subject,—a matter which would not be useful to American readers.

§ 1752. **For What Length of Time.** — A statute of Ohio provided that "at least sixty days' notice shall be given, in some public paper in general circulation, printed on or nearest to the road, of the time and place or places of paying any installment," etc. A notice published *once* sixty full days before the day of payment, requiring shareholders to make payment "to the treasurer of the company," was held a substantial compliance with this provision, and a substantial compliance was all that was required. It was not necessary that it should be published *continuously* for sixty days. The object of the legislature was fully accomplished by a notice to the stockholder which informed him when, where, and to whom he was to make payment. This notice was ample to accomplish all of these objects. The company had a treasurer. His person and place of business were sufficiently designated by his name, in the connection in which it was employed in this notice, to convey all needful information to those subscribers disposed to fulfill their obligations to the company.[3] Where a stockholder was entitled to a notice for the period of sixty days, and the declaration in the action against him for assessments set forth the dates on which the assessments sued for were made, alleging that the defendant then had notice and was requested to make payment, — it was held, on demurrer, that the court would look to the time of filing the declaration to ascertain whether the sixty days had expired.[4]

[1] Eastern Union R. Co. *v.* Symonds, 5 Ex. 237.

[2] See Watson *v.* Eales, 23 Beav. 294.

[3] Muskingum Valley Turnp. Co. *v.* Ward, 13 Ohio, 120; *s. c.* 42 Am. Dec. 191. See also as to publication of notices of judicial sales, Craig *v.* Fox, 16 Ohio, 567. As to notice of the *place of payment,* see *ante,* § 1694.

[4] Mississippi &c. R. Co. *v.* Gaster, 20 Ark. 455.

§ **1753. Sufficiency of the Demand.**— Where the *by-laws* prescribe the manner in which *notice* of the call shall be given, the giving of such notice is a sufficient demand to authorize the bringing of the action.[1] Where the subscription is, by its terms, payable *in materials* at a given place, but not at a fixed time, a resolution of the directors requiring payment of stock subscriptions *in installments*, is manifestly not a sufficient demand of this sort of a subscription.[2]

§ **1754. When Notice may be by Parol.**— Where the charter of the corporation does not require a *written* notice of calls for stock, a *verbal* notice by the secretary, by order of the president, in pursuance of a resolution of the board of directors, is sufficient.[3]

§ **1755. Service of the Notice.** — Although the *fact* of the notice may be a condition precedent to the right of action by the corporation for the assessment, yet, in respect of the manner of giving it, the statute may be regarded as *directory*, so that personal notice is in fact brought home to the subscriber for the period required by the charter or statute.[4] Thus, where the charter required *publication* of the notice in certain newspapers, a personal service was held good.[5] So, where a by-law required that the notice should be served by letter through the mail, a written notice of the time and place of *sale*, signed by the treasurer, and delivered to the owner of the shares, or left at his dwelling-house, and received by him as soon as he was entitled to receive it by mail, was held sufficient.[6] On the other hand, proof that such notice was duly mailed to the subscriber makes out a *prima facie* case of notification under a statute which implies that he shall have notice of the call.[7] The Supreme Court of Alabama have reasoned that generally, when the law requires notice to be given to a party, but does not specify the mode in which it shall

[1] Penobscot R. Co. *v.* Dummer, 40 Me. 172; *s. c.* 63 Am. Dec. 654.

[2] Ohio &c. R. Co. *v.* Cramer, 23 Ind. 490.

[3] Smith *v.* Tallahassee Branch &c. Co., 30 Ala. 650. See also Crozer *v.* Leland, 4 Whart. (Pa.) 12.

[4] Mississippi &c. R. Co. *v.* Gaster, 20 Ark. 455.

[5] *Ibid.*

[6] Lexington &c. R. Co. *v.* Chandler, 13 Metc. (Mass.) 311.

[7] Braddock *v.* Philadelphia &c. R. Co., 45 N. J. L. 363.

be given, *personal notice* must be given and proved, before any liability can be fixed on him; but that this principle does not apply to the case of a defaulting subscriber to the capital stock of an incorporated railroad company, when such personal notice is not required by the charter of the company, nor by the terms of the subscription.[1]

§ 1756. Notice by Publication. — Many charters and statutes provide for the giving of notice of the call by publication in some newspaper for a stated period of time. Where this mode of giving notice is prescribed, it is indispensable that it should be followed,[2] unless where the view is taken that the statute is so far *directory* that personal notice, which is in point of fact better than a notice by a publication which may never fall under the eye of the stockholder, — is a sufficient substitute for the statutory mode.[3] This mode of giving notice has been held *reasonable;*[4] but how this question could arise where it is the mode prescribed by the governing statute is not clear. Such a mode of giving notice has been held sufficient where the paper was published at the place of residence of the stockholder, although there may have been an irregular omission to have it published elsewhere;[5] and, it has been held by another court that, although published in a newspaper printed at the place where the corporation usually transacts its business, the like notice may be given by receivers of an insolvent corporation, appointed by the court.[6] On the other hand, a notice in a newspaper published in a town, not the capital of the State, was held not a sufficient notice to a stockholder, who did not reside in the county in which the town was situated.[7] It has been held that the *affidavit* of the publisher's clerk is sufficient evidence of the publication of a notice calling for payment of installments of stock

[1] Grubbs *v.* Vicksburg &c. R. Co., 50 Ala. 398. See also Fisher *v.* Evansville &c. R. Co., 7 Ind. 407.

[2] Turnpike Co. *v.* Meriweather, 5 B. Mon. (Ky.) 13; Macon &c. R. Co. *v.* Vason, 57 Ga. 314.

[3] *Ante*, § 1775.

[4] Turnpike Co. *v.* Meriweather, 5 B. Mon. (Ky.) 13.

[5] Dinkgrave *v.* Vicksburg Co., 10 La. An. 514.

[6] Hall *v.* United States Ins. Co., 5 Gill (Md.), 484.

[7] Alabama &c. R. Co. *v.* Rawley, 9 Fla. 508.

in a newspaper;[1] but this is clearly erroneous unless there is a statute making it evidence. Without the aid of such a statute, no *ex parte* affidavit is evidence in a court of justice.[2]

§ 1757. **Notice Given in Name of Corporation before Change of Name.** — Where, after the making of a subscription to the capital stock of a corporation, the legislature had passed an act amending its charter, by which its powers were extended and its name was changed, it was not a good defense to an action against such subscriber for an assessment, that notice of such assessment had been communicated to him in the original name of the corporation. Gibson, C. J., said: "The mistake of the corporate name, in giving notice of the call on the stockholders for their installments, was immaterial. Notice of such a call is necessary only to subject them to the penalty of two per cent. a month for default of payment; not to found an action for the principal, which may be demanded on the foot of the call without notice of it. Here the action is for the two installments due, while the demand of the penalty is waived."[3]

[1] Andrews *v.* Ohio &c. R. Co., 14 Ind. 169.

[2] It is well known that there are in many States statutes providing for the publication of judicial and other notices, which make the affidavit of the publisher *prima facie* evidence of the fact of publication.

[3] Gray *v.* Monongahela Nav. Co., 2 Watts & S. (Pa.) 156; *s. c.* 37 Am. Dec. 500, 504; *ante*, § 289 *et seq.*

TITLE THREE. REMEDIES AND PROCEDURE TO ENFORCE SHARE SUBSCRIPTIONS.

CHAPTER XXVIII.

FORFEITURE OF SHARES FOR NON-PAYMENT OF ASSESSMENTS.

ARTICLE I. POWER TO FORFEIT AND HOW EXERCISED.

§ 1762. Requisites of a Valid Forfeiture: a Lawful Authority and a Declared Intention to Forfeit Carried into Effect. — Three things are necessary to a valid forfeiture of shares: 1. An authority to forfeit derived from statute.[1] 2. An expressed intention to forfeit.[2] 3. This intention carried into effect with due formality.[3]

[1] See next section.
[2] *Post,* § 1764.
[3] *Post,* § 1765 *et seq.*

§ 1763. Power to Forfeit must be Conferred by Statute. — A corporation has no inherent power to forfeit or sell the shares of stock owned by delinquent stockholders. It is not a common law remedy, and can only be exercised when it is expressly conferred by some statute, or by the articles of incorporation.[1] One court has, however, held that a corporation having no power to declare stock forfeited for non-payment of subscriptions may, after failing to collect the full amount by suit, *collect the rest by a sale* of the stock.[2] A clause in the articles of an English company, empowering the directors to forfeit the shares of any member who shall take any legal proceedings against the company has been held invalid on obvious grounds.[3] As stated by Sir Nathaniel Lindley, citing the marginal cases, — " Even a majority of shareholders cannot confer it unless empowered so to do by the company's act, charter, deed of settlement, or regulations.[4] But if there is power to forfeit for non-payment of calls, that power may be extended to non-payment of additional capital which may be authorized to be raised.[5]

§ 1764. An Expressed and Bona Fide Intention to Forfeit. — Moreover, it is necessary to a valid forfeiture that there should have been an expressed and *bona fide* intention to forfeit the shares. As has been pointed out by Sir Nathaniel Lindley: " The power to forfeit is a trust, the execution of which will be

[1] Budd *v.* Multonoma Street R. Co., 15 Ore. 413; *s. c.* 3 Am. St. Rep. 169, 173; Westcott *v.* Minnesota Mining Co., 23 Mich. 145; Hill *v.* Nisbet, 100 Ind. 341; Cook Stock., § 123; Hart *v.* Clarke, 6 DeGex M. & G. 232; *s. c.* 6 H. L. 633; Norman *v.* Mitchell, 5 De Gex M. & G. 648; Barton's Case, 4 Drew. 535; *s. c.* 4 De Gex & J. 46. As to companies partly English and partly foreign, see Sudlow *v.* Dutch Rhenish R. Co., 21 Beav. 43. The right to forfeit the shares of members is analogous to the right to *expel* members from corporations, — as to which see *ante*, § 846, *et seq.*; Osgood *v.* Nelson, L. R. 5 H. L. 636; Grant on Corp. 262, 269. As to expulsion from a club, see Hopkinson *v.* Marquis of Exeter, 5 Eq. 63; Fisher *v.* Keane, 11 Ch. Div. 353; Labouchere *v.* Earl of Wharncliffe, 13 Ch. Div. 346; Dawkins Antrobus, 17 Ch. Div. 615; and from a trade association, Strick *v.* Swansea Tin Plate Co., 36 Ch. Div. 558; Rigby *v.* Connol, 14 Ch. Div. 482.

[2] Chase *v.* East Tennessee &c. R. Co., 5 Lea (Tenn.), 415.

[3] Hope *v.* International Financial Society, 4 Ch. Div. 327.

[4] Barton's Case, 4 Drew. 535; *s. c.* affirmed on appeal, 4 De G. & J. 46.

[5] See Kelk's Case, 9 Eq. 107.

narrowly scanned by the court.[1] It cannot, for example, be exercised surreptitiously, for the purpose of expelling a shareholder;[2] nor by connivance, for the purpose of assisting him in getting rid of shares and retiring from the company, in fraud of the other shareholders. A court will not sanction or recognize as valid a forfeiture made *mala fide* for any such purpose." Accordingly, where the intention was not to forfeit the shares, but merely to *cancel* them, the shareholder remained a contributory.[3] It is upon this ground that the invalidity of collusive forfeitures rests, — a subject already considered.[4]

§ 1765. This Intention must be Carried into Effect Formally.— But a declared intention to forfeit the shares of the member, although made *bona fide*, will not be effective to that end unless the formalities required by law are substantially taken, as pointed out in the next section. Accordingly where notice was given to a shareholder that unless he paid his calls which were in arrear, by a day named, his shares would be forfeited without further notice, and he thereupon paid his calls due on some of them, but not on the others, stating that he would submit to their forfeiture; but the directors, nevertheless, did not declare them forfeited, but kept his name on the books as before,— he was held a contributory on the winding-up of the company in respect of all of his shares.[5]

§ 1766. Power must be Exercised in Mode Prescribed by Statute: By-law when Necessary. — Another principle is that, where this power is conferred by a statute which, at the same time, points out the mode in which it shall be exercised, it can only be exercised in the mode so pointed out. Thus, if the statute which confers the power prescribes that it shall be exercised by a

[1] Blisset *v.* Daniel, 10 Hare, 483; Harris *v.* North Devon R. Co., 20 Beav. 384; Stubbs *v.* Lister, 1 Younge & C. 81. See also Stewart's Case, L. R. 1 Ch. 511; and Sweny *v.* Smith, L. R. 7 Eq. 324.

[2] See cases in the preceding note.

[3] Esparto Trading Co., 12 Ch. Div. 191.

[4] *Ante*, § 1550 *et seq.*

[5] Bigg's Case, L. R. 1 Eq. 309. See also Birmingham &c R. Co. *v.* Locke, 1 Ad. & El. (N. S.) 256; Edinburgh &c. R. Co. *v.* Hebblewhite, 6 Mees. & W. 707; London &c. R. Co. *v.* Fairclough, 2 Man. & Gr. 674. Compare Miller's Case, 3 Ch. Div. 661, and 5 *Id.* 70.

by-law, the company cannot exercise it until it has made a by-law such as the statute prescribes, and then its compliance with the by-law must affirmatively appear, in order to show the validity of the exercise of the power.[1] The principle that forfeitures are not favored in the law justifies the conclusion that the power of a corporation to forfeit the shares of its members for non-payment of assessments must be pursued with great strictness. It can only be exercised by directors who have been properly elected or appointed; [2] and the proper number must concur in the resolution to forfeit.[3]

§ 1767. Illustration of this Principle.— By a statute of Oregon, a corporation is empowered, "to make by-laws, not inconsistent with any existing law, for the sale of any portion of its stock for delinquent or unpaid assessments due thereon, which sale may be made without judgment or execution; provided, that no such sale shall be made without thirty days' notice of time and place of sale in some newspaper in circulation in the neighborhood of such company for the transfer of its stock, for the management of its property, and for the general regulation of its affairs." [4] With this statute in force, a corporation undertook to forfeit the shares of one of its members for non-payment of an assessment, by advertising it for sale in a newspaper for thirty days, and by selling it in pursuance of the advertisement, but without having established any by-law in pursuance of the statute prescribing the mode of forfeiting its shares for the non-payment of assessments. It was held that the attempted forfeiture was void. The fact that the board of directors passed a *resolution* to forfeit the shares of the particular member did not alter the case, such a resolution being in no sense a *by-law*.[5] Nor did it affect the principle that it was not made to appear that any other members were delinquent in the payment of the assessment; since, "if a majority of a board of directors of a private corporation may, in any case, pass such a resolution and enforce it, they may do it in every case. * * * Any by-law, enacted under this

[1] Budd *v.* Multonoma Street R. Co., 15 Ore. 413; *s. c.* 3 Am. St. Rep. 169, 173; Mitchell *v.* Vermont Copper Mining Co., 8 Jones & S. (40 N. Y. Super.) 406; *post*, next section; *ante*, §§ 1037, 1038.

[2] Garden Gulley &c. Co. *v.* McLister, 1 App. Cas. 39.

[3] Bottomley's Case, 16 Ch. Div. 681. But it seems that such an informal forfeiture may be validated by being treated as a good forfeiture both by the company and the shareholder. Lyster's Case, L. R. 4 Eq. 233, where the resolution was passed by two directors out of six.

[4] Hill Code Ore., § 3221, sub-div. 6.

[5] See *ante*, § 936.

section of the code, to be *reasonable*, ought to be *general;* that is, it ought to affect every delinquent subscriber and all delinquent stock alike, and it ought not to be directed against the stock or interests of a particular stockholder. These are essential requisites to a valid by-law." [1]

§ **1768. When By-law Forfeiting Shares Invalid.** — As already seen, while it is competent for corporations to enforce their by-laws by reasonable pecuniary *fines*,[2] yet they cannot annex to them the penalty of a forfeiture of the property.[3] Accordingly, a corporation cannot enforce a by-law which provides for a forfeiture of the shares of the stockholder for non-payment of assessments, unless power to do so is conferred by the charter or governing statute.[4]

§ **1769. The Assessment Must be Legal.** — It equally follows that the assessment for the non-payment of which the forfeiture is attempted must be legal and valid: if illegal and invalid, in whole or in part, it will not authorize a sale of the shares of the delinquent.[5] The requirement that the assessment must be legal implies that it must have been made by the *proper officers* of the corporation. When, therefore, the power to make the assessment was lodged by the charter in the directors, and they undertook to delegate it to a *committee* consisting of the *president* and *treasurer*, to be exercised by them or not in their *discretion*, it was held that a sale of the shares of a member to enforce an assessment ordered by such committee was void, and that an order on the treasurer to assess the shares of members must be made by the board of directors and must be *absolute*, and not in the alternative.[6]

[1] Budd *v.* Multonoma Street R. Co., 15 Ore. 413; *s. c.* 3 Am. St. Rep. 169, 173. As to the reasonableness of by-laws see *ante*, § 1021 *et seq.*

[2] *Ante*, § 1036.

[3] *Ante*, § 1037.

[4] *Ante*, § 1038.

[5] Lewey's Island R. Co. *v.* Bolton, 48 Me. 451; *s. c.* 77 Am. Dec. 236; *Ante*, § 1702.

[6] York &c. R. Co. *v.* Ritchie, 40 Me. 425; *ante*, § 1706, *et seq.* It has been held that a *general resolution* of a railroad company forfeiting stock for non-payment of installments, must declare to the stockholder that they claim to forfeit his specific stock, otherwise it will not be valid. Johnson *v.* Albany &c. R. Co., 40 How. Pr. (N. Y.) 193.

§ 1770. Corporation must Comply with Conditions on its Part. — Where the principle obtains that the right to forfeit the shares for non-payment of assessments is merely cumulative,[1] there will be no right of forfeiture unless the circumstances are such that the company could maintain an action for the unpaid assessments, — just as, in the case of a mortgage, there will be no right of foreclosure if there has been a failure of consideration in respect of the note or bond secured by the mortgage, so that no action could be maintained thereon. On this principle it has been held that a corporation will not be permitted to forfeit the shares of a member for non-payment of assessments, where the subscription was obtained by the agents of the corporation upon conditions with which the corporation has failed to comply.[2]

§ 1771. Forfeiture Enforceable although Project Subsequently Abandoned. — Where, by the terms of the subscription agreement to an *increase* of the capital stock of a corporation, the subscribers are to pay for the new shares in installments, as called for by the directors, and, upon failure to pay for any call for sixty days, are to forfeit all sums theretofore paid upon the subscription, such a forfeiture may be enforced against a subscriber, although the whole project of increasing the capital stock is afterwards abandoned and adjusted by issuing bonds to such of the subscribers as will take them for what they have paid in upon calls made by the directors, provided the project of increasing the capital stock was not illegal. "If," said Wallace, J., "the subscription agreement was valid, the plaintiff can have no redress, but must be held to his stipulation to forfeit the payment for his delinquency in responding to subsequent calls. The defendant had become entitled to the plaintiff's money by the terms of the subscription agreement, at the time it concluded to abandon the scheme for increasing its capital, and, however hard and inequitable it may seem that the defendant should retain this money, while abandoning the project for which it was received, its legal right so to do is clear. On the other hand, if the subscription was executed as part of an illegal

[1] *Ante*, § 1550; *post*, § 1784.

[2] Frankfort &c. Turnpike Co. *v.* Churchill, 6 T. B. Mon. (Ky.) 427; *s. c.* 17 Am. Dec. 159.

scheme, it is void in all of its conditions, and the defendant can take nothing under color of the forfeiture stipulated for. The sole question, in my view, therefore, is, whether the plaintiff will be permitted to recover money paid in partial performance of an illegal transaction. The defendant has no right to the money, unless that of possession, under circumstances which deny to the plaintiff the assistance of the court in reclaiming it. Certain propositions applicable to the present case are not debatable. Courts of justice refuse to entertain any application to enforce a contract or transaction which is immoral, or subversive of public policy, or in contravention of a statute. When the transaction has been consummated, or the contract has been executed, if the parties to it are *in pari delicto*, neither will be permitted to recover money or property delivered to the other in furtherance of it. When the law which the transaction contravenes is designed for the coercion of one party, or the protection of the other, or where one party is the principal offender and the other acquiesces by constraint of circumstances, the parties are not *in pari delicto*, and the lesser offender will be relieved, although the illegal transaction has been consummated."[1]

§ 1772. But Dissenting Shareholder may Recover back his Installments. — But, assuming such an agreement to increase the capital stock of the corporation to be illegal, the dissenting shareholder may recover back his installments, on the principle that a recovery can be had, as for money had and received, where the illegality consists in the contract itself, and the contract has not been executed, in which case there is a *locus penitentiæ*, the *delictum* being incomplete, and the contract may be rescinded by either party.[2] "A different rule," it was well

[1] Knowlton *v.* Congress &c. Co., 14 Blatchf. (U. S.) 364; 10 Myer Fed. Dec., § 135.

[2] Knowlton *v.* Congress &c. Co., 14 Blatchf. (U. S.) 364; 10 Myer Fed. Dec., § 136; denying, on this point, *s. c.* 57 N. Y. 518, and concurring in the dissenting opinion of Mr. Commissioner Dwight, that "if the contract continues executory, and the party paying the money be desirous of rescinding it, he may do so, and recover back his deposit." This case was an action by a stockholder to recover back the installments which he had paid in respect of shares for which he had subscribed under a scheme to increase the capital stock of the company, under the circumstances above stated. It was conceded by counsel that the proceedings to increase the capital stock were illegal, as being in

observed, "would hold out an inducement to the parties to an illegal transaction to persevere in their efforts to violate the law."[1]

§ 1773. Waiver of Right of Forfeiture by Failing to Sell for Each Delinquency. — If a judge were to announce the doctrine that in the case of a mortgage securing a debt due in installments, the mortgagee loses his right of foreclosure by waiting till the whole is due, he would be thought to be a fool. But one court has held that where a corporation has power to sell the stock of a corporator for the payment of each call as it is made, and to hold the stockholder responsible for the deficiency, if the corporation fails to sell the stock as each successive defalcation occurs, and waits until all the calls are made, it thereby loses its remedy by sale.[2] But another court has, with better sense, held the contrary.[3]

§ 1774. Previous Misappropriation of Corporate Funds. — We shall see, when we come to consider the subject of actions

contravention of the statute under which the company was organized, and constructively fraudulent as to the public and as to all stockholders not assenting thereto. The plaintiff recovered a judgment in the State court, which was reversed by the commission of appeals and the cause remanded for a new trial. Knowlton *v.* Congress &c. Co., 57 N. Y. 518. The commission of appeals held (Dwight, Comr., dissenting) that money paid by one party in *part performance* of an illegal contract cannot be recovered back, where both parties are *in pari delicto*, and that no distinction exists as to the right of recovery, between cases of partial and of entire performance. After the cause had been remanded to the trial court, it was removed to the Circuit Court of the United States, and in this court Mr. District Judge Wallace denied the doctrine announced in the State court and gave judgment for the plaintiff. He rested his conclusion that there is in such a case a *locus penitentiæ* and right of rescission in either party, the *delictum* not being complete, upon the following decisions: Walker *v.* Chapman, Lofft. 342; Lowry *v.* Bourdieu, Doug. 452; Tappenden *v.* Randall, 2 Bos. & P. 467; Hastelow *v.* Jackson, 8 Barn. & Cres. 221, 226; Rusk *v.* Walsh, 4 Taunt. 290; Bone *v.* Ekless, 5 Hurl. & N. 925; White *v.* Franklin Bank, 22 Pick. (Mass.) 181; Nellis *v.* Clark, 4 Hill (N. Y.), 424; Morgan *v.* Groff, 4 Barb. (N. Y.), 524; Taylor *v.* Bowers, 34 L. T. (N. S.) 938. That equity will interfere in such cases even in behalf of one who is *particeps criminis*, see Story Eq. Jur , § 298; Neville *v.* Wilkinson, 1 Brown Ch. 548, note a.

[1] Knowlton *v.* Congress &c. Co., *supra*, per Wallace, J.

[2] Stokes *v.* Lebanon &c. Turnp. Co., 6 Humph. (Tenn.) 241.

[3] Brockenbrough *v.* James River &c. Co., 1 Patt. & H. (Va.) 94.

for assessments, that such defenses as that the directors have misappropriated the corporate funds have been brushed away by the courts as trivial. On similar grounds it has been held that, where a sale of the shares of a member had been made under a valid assessment to raise funds needed for lawful purposes, it was not void for the reason that the directors may have previously misappropriated the corporate funds.[1]

§ **1775. Estoppel to Forfeit Shares of a Member.** — The company may, however, be estopped by its conduct from forfeiting the shares of a member. This will appear by a case where the officer in charge of a bank — his grade does not appear, — informed a party applying to the bank for information, that he might safely lend money to one of its stockholders, and that the stock was free from incumbrance. Acting upon the faith of this information, the applicant advanced money, taking a *pledge* of the shares for his security. It was held that the bank was thereafter estopped from forfeiting the stock for assessments due thereon by the pledgor.[2]

§ **1776. Waiver of Forfeiture for Non-Payment of Premium.** — The law will not favor, but will rather lean against the forfeiture of a mutual insurance policy for a want of promptness in paying the premium note. But where a forfeiture has occurred, if the company afterward proposes to accept the payment of the note in a particular way, and its proposition is at once accepted, and unconditionally complied with, the forfeiture is waived.[3]

§ **1777. Notice of the Intention to Forfeit.** — The principle that the right of forfeiture must be pursued with great strictness includes the proposition that the shareholder must have the prescribed notice of the intention to forfeit his shares, in default of which the forfeiture will be void. It has even been held in England that a shareholder whose shares have been regularly forfeited, but without notice to him, is entitled to prove damages

[1] Marshall *v.* Golden Fleece &c. Mining Co., 16 Nev. 156.

[2] Moore *v.* Bank of Commerce, 52 Mo. 377.

[3] Sims *v.* State Ins. Co., 47 Mo. 54; *s. c.* 4 Am. Rep. 311.

therefor, in competition with other creditors of the company where the company is wound up.[1]

§ 1778. **Mode of Sale.**— In respect of the mode of sale the governing statute must be strictly pursued. When, therefore, the charter of a railroad company authorized such a sale to take place at the post-office in the particular town, and at public auction, it was held that it could take place in no other place or manner.[2] In like manner, where no such sale is allowed by the governing statute except under regulations established in the form of *by-laws*, and no such regulations have been made, there can be no valid sale.[3]

§ 1779. **What Notice of Sale must be Given.**— Where the charter or governing statute prescribes the *time* or duration of the notice and the *manner* of giving it, these requirements must be strictly followed, or the sale will be void.[4] Where the length of *time* of the notice is not prescribed by the governing statute or by an authoritative by-law, a notice must be given for a *reasonable* time; and it has been held that *three days* notice is *unreasonably short*, and therefore insufficient, if the proprietor resides at a distance.[5] Moreover the notice must be certain as to the *place* of sale; and therefore a notice which merely stated that a sale would be made by an auctioneer named, who was and long had been an auctioneer at the place where the notice bore

[1] Re New Chili Gold M. Co., 45 Ch. Div. 598. For cases illustrating the insufficiency of notices in such cases see Johnson *v.* Lyttle's Iron Agency, 5 Ch. Div. 687; Watson *v.* Eales, 23 Beav. 294; Van Diemen's Land Co. *v.* Cockerell, 1 C. B. (N. S.) 732, affirming Cockerell *v.* Van Diemen's Land Co., 18 C. B. 454; Edinburgh &c. R. Co. *v.* Hebblewhite, 6 Mees. & W. 707; London &c. R. Co. *v.* Fairclough, 2 Man. & Gr. 674. Compare Graham *v.* Van Diemen's Land Co., 1 Hurl. & N. 541.

[2] Lewey's Island R. Co. *v.* Bolton, 48 Me. 451; *s. c.* 77 Am. Dec. 236.

[3] Mitchell *v.* Vermont Copper Mining Co., 8 Jones & S. (40 N. Y. Super.) 406; *ante*, § 1766. The provisions of Mass. Rev. Stat. ch. 30, § 53, as to the mode in which shares of a stockholder in a corporation may be sold for the non-payment of assessments, do not apply to the case of new shares offered to *existing stockholders*, and sold because not taken by such stockholders. Sewall *v.* Eastern R. Co., 9 Cush. (Mass.) 5.

[4] Lewey's Island R. Co. *v.* Bolton, 48 Me. 451; *s. c.* 77 Am. Dec. 236; *post*, next section.

[5] Lexington &c. R. Co. *v.* Staples, 5 Gray (Mass.), 520.

date, was insufficient, because it did not express the *place of sale*.[1] Reasonable certainty is also required in *describing the shares* which are to be sold, but this rule is complied with by a description which clearly identifies them.[2] The subject of the sufficiency of *notice of assessments* in order to support an action thereon is considered in another place.[3]

§ 1780. Instance of Defective Compliance with the Statute as to Notice of Sale.—The charter of a company authorized the directors to make assessments, and provided that "the treasurer shall give notice of all such assessments, and, in case any subscriber or stockholder shall neglect to pay any assessment for the space of thirty days after such notice is given as shall be prescribed by the by-laws of said corporation, the directors may order the treasurer to sell such share or shares at public auction, after giving such notice as may be prescribed as aforesaid, to the highest bidder." The same statute provided that the delinquent subscriber or stockholder should be held liable to the corporation for any deficiency after the sale. The by-laws of the company provided that the notice of assessments might be given by publication, or, "by a personal notice from the treasurer of the company," and in case the directors should order a sale under the fourth section of the act, the treasurer should give forty-eight hours' notice of the time and place of sale, by posting "notices of the same in two conspicuous public places in the city of Calais, and shall notify such delinquent subscriber whose stock is to be sold, by leaving, or causing to be left, a copy of such notice at his place of residence, or by giving him *in hand* such notice, to be *signed* by the treasurer, or by one of the directors in his behalf." Under this statute, it was held that the corporation could not, after proceeding to forfeit and sell the shares of the delinquent, recover the deficiency without showing that thirty days notice had been given him of the assessments *before the order to the treasurer* to sell the shares; that the shares were sold at public auction; that the sale took place at the post-office in Calais; that the notice of the time and place of sale which was delivered to the defendant *in hand*, was *signed* by the treasurer, or by the director in his behalf, and that the notices intended to advise the public of the sale were posted in "two *conspicuous* public places" in the city of Calais, the evidence going no further than to show that they were posted in two *public* places in that city.[4]

[1] *Ibid.*

[2] York &c. R. Co. *v.* Pratt, 40 Me. 447.

[3] *Ante*, § 1746 *et seq.*

[4] Lewey's Island R. Co. *v.* Bolton, 48 Me. 451; *s. c.* 77 Am. Dec. 236.

Article II. Effect of Such Forfeitures.

§ 1784. View that the Remedy by Forfeiture of Shares is Cumulative merely.— The courts which hold to the prevailing doctrine, that a subscription to the stock of a corporation implies an undertaking to pay for the shares,[1] take the correlative view, that the remedy given to the corporation by the charter to enforce compliance with the contract of subscription by forfeiting the shares of the delinquent, is *cumulative merely*, and does not negative the right of the corporation to sue for the assessments.[2]

On the last point the court cite Bearce *v.* Fossett, 34 Me. 575, where it was held that an officer's return that he posted certain notices in a public place, without saying in a public and conspicuous place, as required by the statute, was insufficient. That statutes requiring notice to be given, and the service of it to be proved in a particular mode, are to be strictly pursued, is held in Newby *v.* Perkins, 1 Dana (Ky.), 440; *s. c.* 25 Am. Dec. 160.

[1] *Ante*, § 1138.

[2] Selma &c. R. Co. *v.* Tipton, 5 Ala. 787; *s. c.* 39 Am. Dec. 344; Beene *v.* Cahawba &c. R. Co., 3 Ala. 660; Instone *v.* Frankfort Bridge Co., 2 Bibb (Ky.), 576; *s. c.* 5 Am. Dec. 638; Hightower *v.* Thornton, 8 Ga. 486; *s. c.* 52 Am. Dec. 412; Greenville &c. R. Co. *v.* Cathcart, 4 Rich. (S. C.) 89; Freeman *v.* Winchester, 10 Smed. & M. (Miss) 577; Commercial Bank *v.* State, 6 Smed. & M. (Miss.) 599; Mann *v.* Currie, 2 Barb. (N. Y.) 294; Ogdensburgh &c.

The company may, in case of the non-payment of the assessments, either bring an action against the stockholder to recover them, or declare the shares forfeited;[1] and where the charter provides that the shares shall be liable to forfeiture, and that the company *may* declare the same forfeited and vested in the company, the option to forfeit is with the company, and not with the stockholder.[2] From the same principle another conclusion follows, namely, that an *unsuccessful attempt* on the part of the corporation *to sell* the shares does not deprive it of its remedy against the delinquent shareholder by action;[3] and of course a mere unexecuted *threat* so to do, will not have such an effect.[4] Moreover, as the corporation has its *election* whether or not it will resort to the remedy by forfeiture, its failure to do so will be no ground of forfeiting its charter.[5] And where there is, in the contract of subscription, an *express promise to pay* for the shares, all the courts, including those which hold that such an express promise is necessary to give a right of action for assessments,[6] agree that the corporation may maintain thereon an action for assessments, notwithstanding the charter or governing statute gives it a remedy by forfeiture.[7] It has even been

R. Co. *v.* Frost, 21 Barb. (N. Y.) 541. Goshen &c. Turnpike Road *v.* Hurtin, 9 Johns. (N. Y.) 217; *s. c.* 6 Am. Dec. 273; Kennebec &c. R. Co. *v.* Jarvis, 34 Me. 360. Troy &c. R. Co. *v.* Tibbits, 18 Barb. (N. Y.) 298; Raymond *v.* Caton, 24 Ill. 123; South Bay Meadow Dam Co. *v.* Gray, 30 Me. 547; Buffalo &c. R. Co. *v.* Dudley, 14 N. Y. 336; Barbee *v.* Plank Road Co., 6 Fla. 262; Worcester Turnpike Corp. *v.* Willard, 5 Mass. 80; *s. c.* 4 Am. Dec. 39; Boston &c. R. Co. *v.* Wellington, 113 Mass. 79; Stokes *v.* Lebanon &c. Turnp. Co., 6 Humph. (Tenn.) 241; Great Northern R. Co. *v.* Kennedy, 4 Ex. 417; Inglis *v.* Great Northern R. Co., 1 Macq. 112. In Edinburgh &c. R. Co. *v.* Hebblewhite, 6 Mees. & W. 707, Giles *v.* Hutt, 3 Ex. 18, London &c. R. Co. *v.* Fairclough, 2 Man. & Gr. 674, there was only an option to sue or forfeit. Compare Mann *v.* Cooke, 20 Conn. 178.

[1] Herkimer &c. Co. *v.* Small, 21 Wend. (N. Y.) 273; Troy &c. Co. *v.* M'Chesney, 21 Wend. (N. Y.) 296.

[2] North Eastern Co. *v.* Rodrigues, 10 Rich. L. (S. C.) 278.

[3] Instone *v.* Frankfort Bridge Co., 2 Bibb (Ky.), 576; *s. c.* 5 Am. Dec. 638.

[4] Macon &c. R. Co. *v.* Vason, 57 Ga. 314.

[5] Commercial Bank *v.* State, 6 Smed. & M. (Miss.) 599.

[6] *Ante*, § 1187.

[7] Goshen &c. Turnp. Road *v.* Hurtin, 9 Johns. (N. Y.) 217; *s. c.* 6 Am. Dec. 273; Dutchess Cotton Man. Co. *v.* Davis, 14 Johns. (N. Y.) 238; *s. c.* 7 Am. Dec. 459; Worcester Turnp. Corp. *v.* Willard, 5 Mass. 80; *s. c.* 4 Am. Dec. 39; Taunton Turnp. Corp. *v.* Whiting, 10 Mass. 327; *s. c.* 6 Am. Dec. 124; White Mountain R. Co. *v.* Eastman, 34 N. H. 124; New Hampshire Central

held that such an express promise to pay may be enforced by an action, although the charter provides no other remedy than a sale of the stock.[1]

§ 1785. **When Exclusive.** — Schemes of incorporation exist under which the remedy by forfeiture is held exclusive, — as in the case of a mining company in California.[2] And we have already had occasion to refer to a view,[3] deemed untenable,[4] that unless there is, in the contract of subscription, an express promise to pay for the shares, the only remedy of the corporation, in case assessments thereon are not paid, is to forfeit them.

§ 1786. **Effect of Forfeiture Pending Action for Assessments.** — It has also been held that where an action has been commenced to recover certain installments of the subscription which have been duly called for, and then a further call is made, and the stock forfeited for non-payment thereof, the subscriber may plead such forfeiture in bar of the further maintenance of the suit.[5] The overruled cases hold that if, after suit brought they declare a forfeiture of the stock, it cannot be pleaded in bar to the further maintenance of the suit, where the stock forfeited is not equal to the money due to the company; but the value of the stock should be allowed in diminution of the sum which the plaintiffs would otherwise be allowed to recover.

§ 1787. **Corporation may Sue for Balance Due after Forfeiture and Sale.** — It is a principle relating to mortgages, that the balance due after the foreclosure of a mortgage may be recovered at law by a suit on the bond or other written obligation which was secured by the mortgage.[6] By analogy to this

R. Co. *v.* Johnson, 30 N. H. 390; *s. c.* 64 Am. Dec. 301; Troy &c. R. Co. *v.* Kerr, 17 Barb. (N. Y.) 681.

[1] Connecticut &c. Co. *v.* Bailey, 24 Vt. 465; *s. c.* 58 Am. Dec. 181.

[2] Re South Mountain Consolidated Mining Co., 7 Sawy. (U. S.) 30. That an action of assumpsit cannot be maintained to collect assessments upon *full paid* stock where another mode of collection is prescribed by the *by-laws*, see Belmont Park Assoc. *v.* Toller, 6 Pa. County Ct. 266.

[3] *Ante*, § 1187.

[4] *Ante*, § 1188.

[5] Small *v.* Herkimer Man. Co., 2 N. Y. 330, overruling Herkimer &c. Co. *v.* Small, 21 Wend. (N. Y.) 273; Troy &c. Co. *v.* McChesney, 21 Wend. (N. Y.) 296.

[6] Globe Ins. Co. *v.* Lansing, 5 Cow. (N. Y.) 380; *s. c.* 15 Am. Dec. 474;

principle, it is frequently held that the stockholder is liable to the corporation for any balance due after selling his shares to enforce his liability for assessments thereon and applying the proceeds in satisfaction of the indebtedness and costs.[1] According to one court, if the subscriber agrees to take only a specified number of shares, without expressly promising to pay assessments, then resort must first be had to a sale of his shares to pay the assessments, *before* an action at law can be maintained, — implying that after the exhaustion of the remedy by forfeiture, the corporation may maintain an action for any residue.[2] The same court has subsequently held that, where a corporation adopts a *by-law* providing that if any subscriber for stock shall not pay the assessments upon such stock within thirty days after notice of the same, said stock shall be sold at auction to pay the expenses of the sale and the assessments, and a person subscribes for shares in the corporation, and by the terms of his subscription expressly promises to pay assessments thereon, he will be liable in assumpsit for assessments made upon his stock, *before* resort is had to a sale of his shares under the by-law.[3]

§ **1788. Statutory Right of Action for Residue.** — But those courts which take the view that an *express promise*[4] in the subscription paper to pay for the shares is necessary to support an action for assessments, and that the only remedy, in the absence of such a promise, is to forfeit the shares, are driven, by the mere logic of their position, to hold that, after forfeiting and reselling the shares, there can be no action for any unsatisfied balance; since the subscriber has made no promise which, in the view of those courts, will support an action.[5] Under this view,

Lansing *v.* Goelet, 9 Cow. (N. Y.) 346; Spencer *v.* Harford, 4 Wend. (N. Y.) 381; Case . Boughton, 11 Wend. (N. Y.) 106; Dunkley *v.* Van Buren, 3 Johns. Ch. (N. Y.) 331, per Kent, Chancellor; Tooke *v.* Hartley, 2 Bro. C. C. 125; Hatch *v.* White, 2 Gall. (U. S.) 152; Amory *v.* Fairbanks, 3 Mass. 562.

1 Merrimac &c. Co. *v.* Bagley, 14 Mich. 501; Brockenbrough *v.* James River &c. Co., 1 Patt. & H. (Va.) 94; Herkimer Man. Co. *v.* Small, 21 Wend. (N. Y.) 273.

2 New Hampshire Central Railroad *v.* Johnson, 30 N. H. 390; *s. c.* 64 Am. Dec. 301.

3 Piscataqua Ferry Co. *v.* Jones, 39 N. H. 491.

4 *Ante*, § 1187.

5 Mechanics' Foundry &c. Co. *v.* Hall, 121 Mass. 272; Andover &c. Turnpike Co. *v.* Gould, 6 Mass. 40.

if any such right of action exists, as it does not arise out of *contract*, it must necessarily be given by the charter or other applicatory *statute*, which, as already seen, in theory of law, enters into and forms a part of the contract of subscription, so that the shareholder is conclusively charged with notice of its provisions.[1] But these courts reason that this right of action to recover any unsatisfied balance after forfeiture and sale, being a right of action upon a statute liability,[2] the terms of the statute giving it must be *strictly complied with*.[3] Moreover, in order to support such an action, it must affirmatively appear, that the sale was made for a legal assessment and did not include any illegal one.[4] When, therefore, the governing statute prescribes the terms on which shares in the stock of a railroad company may be sold for the payment of assessments, and the shareholder be held to pay the balance if the shares are not sold for a sum sufficient to pay the assessment, — those terms are, in this view, *conditions precedent*, and, unless they are strictly complied with, the sale is illegal, and the shareholder not chargeable.[5]

§ 1789. Illustration: Case of a Double Assessment. — When, therefore, the charter provided that "no assessments shall be laid upon any share in said corporation of a greater amount in the whole than one hundred dollars," and it appeared from the record that assessments had been made to the amount of one hundred dollars on each share, and that thereafter another assessment of one hundred dollars on each share had been voted, with the proviso that whatever sum had been paid on former assessments should be allowed on the new assessment towards the payment thereof, and this vote did not abrogate or annul the former assessments in terms, and it did not appear whether the shares of the defendant had been sold for a non-payment of all the assessments or only upon the last, — it was held that an action could not be maintained

[1] *Ante*, § 1137.

[2] That a *by-law* providing that the subscriber shall, after a sale, be liable for any deficiency, will not sustain an action for such a deficiency, see Kennebec &c. R. Co. *v.* Kendall, 31 Me. 470; Jay Bridge Corp. *v.* Woodman, 31 Me. 573.

[3] Portland &c. R. Co. *v.* Graham, 11 Metc. (Mass.) 1; Lexington &c. R. Co. *v.* Staples, 5 Gray (Mass.), 522; Lewey's Island R. Co. *v.* Bolton, 48 Me. 451; *s. c.* 77 Am. Dec. 236.

[4] Stoneham Branch R. Co. *v.* Gould, 2 Gray (Mass.), 277; Lewey's Island R. Co. *v.* Bolton, 48 Me. 451; *s. c.* 77 Am. Dec. 236, 239.

[5] Portland &c. R. Co. *v.* Graham, 11 Metc. (Mass.) 1.

for any residue, because it did not appear that his shares had been sold upon a legal assessment.[1]

§ **1790. Shareholder Entitled to Residue.** — The view which assimilates the right to forfeit the shares to the case of a mortgage,[2] not only carries with it the conclusion that if, upon a sale of the shares to enforce the forfeiture, they bring less than the amount due thereon, the corporation may sue for the balance; but also the conclusion that if they bring more, the corporation must turn over the excess to the shareholder.[3]

§ **1791. Status of the Shares after Forfeiture.** — We shall hereafter see that a corporation has the power to become the owner of such of its own shares as have been forfeited to it for non-payment of assessments made thereon.[4] Generally, what is called a forfeiture of shares takes the form of a sale of them to some third party, after notice.[5] But in some cases a direct forfeiture takes place by the mere act of the directors in passing a resolution to that effect, where the charter gives them power so to do. So, in the case of a sale, if there be no bidder, the corporation may, it is supposed, become, in form at least, the purchaser. What then becomes of the shares? They cannot, from their very nature, continue to exist as separate choses in action, for it is impossible in a strict sense for a corporation to be owner of its own shares. It seems that they become *merged* in the general body of the property of the corporation, or at most remain in its hands, like shares that have never been issued, mere *potentialities* subject to be revived by a re-issue.[6] Under the California Civil Code,[7] if stock of a corporation is bought in by it upon a sale for delinquent assessments, the legal title vests in the corporation, but the stock is held subject to the control of the stockholders. It was held that stock so bought in is not

[1] Lewey's Island R. Co. *v.* Bolton, 48 Me. 451; *s. c.* 77 Am. Dec. 236.

[2] *Ante*, § 1787.

[3] Herkimer Man. Co. *v.* Small, 21 Wend. (N. Y.) 273; Mitchell *v.* Vermont Mining Co., 47 How. Pr. (N. Y.) 223. Compare Trustee *v.* Winston, 5 Stew. & Port. (Ala.) 17. That this view has been overruled in New York, see Small *v.* Herkimer Man. Co., 2 N. Y. 330 (reversing the decision first above cited).

[4] *Post*, § 2068.

[5] *Ante*, § 1778 *et seq.*; § 1787

[6] See *post*, § 2069.

[7] Cal. Civ. Code, § 334

subject to resale on execution issued against the corporation in satisfaction of its debts.[1]

§ 1792. What Forfeiture Releases Shareholder's Liability. — If there is not strictly a forfeiture, but rather a *foreclosure* of the lien of the corporation on the shares by a *sale* of them after notice,[2] then, as already seen, according to the prevailing opinion, the shareholder, while losing his rights as a shareholder, remains liable to the corporation for the deficiency.[3] But where there is a strict forfeiture, by a resolution of the directors, as explained in the preceding section, by which the corporation seizes the shares to its own use, this severs the connection of the shareholder with the corporation, and he thereupon ceases to be a stockholder, or to be further liable for his unpaid subscription.[4] And where the forfeiture has taken the form of a sale of the shares by the corporation upon notice, it may be safely assumed that the purchaser takes them subject to future assessments; and the connection of the shareholder with the corporation ceases, except that, as already stated,[5] he may remain liable for any unsatisfied balance due in respect of the assessment already made for which the shares were forfeited and sold. Assuming the forfeiture to be valid in the sense of not being collusive or *ultra vires*, he thereby ceases to be a stockholder for all future purposes.[6] But if the forfeiture is invalid in respect of something which the parties cannot waive and which cannot be cured by their acquiescence, he remains liable to the company's creditors in the event of its insolvency.[7] On the other hand, where there has been a mere irregularity in making a *bona fide* forfeiture within the company's powers, — as by failing to give him the prescribed notice, or to pass a formal resolution of

[1] Robinson *v.* Spaulding Gold &c. Min. Co., 72 Cal. 32; *s. c.* 13 Pac. 65.

[2] *Ante*, § 1779.

[3] *Ante*, § 1787.

[4] Mills *v.* Stewart, 41 N. Y. 384; Macauly *v.* Robinson, 18 La. An. 619.

[5] *Ante*, § 1787.

[6] Dawes' Case, L. R. 6 Eq. 232; Kelk's Case, L. R. 9 Eq. 107; Ex parte Collum, *Id.* 236; Strick *v.* Swansea Tin Plate Co., 36 Ch. Div. 558; Bereford's Case, 3 De Gex & Sm. 175; *s. c.* 2 Mac. & G. 197; Ex parte Bailey, 15 Jur. 29.

[7] *Post*, §1797; Ex parte Trading Co., 12 Ch. Div. 191; Bottomley's Case, 16 Ch. Div. 681; Garden Gully Mining Co. *v.* McLister, 1 App. Cas. 39.

forfeiture, but only an entry to that effect on the corporate books has been made by the secretary, — yet if both the company and the shareholder treat the forfeiture as valid, it will be held such as against the company's creditors.[1]

§ **1793. And Releases his Liability to Creditors** — For the same reason, a forfeiture releases his liability to creditors of the corporation, unless as to so much of the calls already made as was not satisfied by the sale of the shares, where the forfeiture takes that form. A creditor of the corporation cannot thereafter charge him with the amount which remains unpaid, under his general engagement as a subscriber.[2] This doctrine, a little more amplified, is that the individual liability of a stockholder for a corporate debt, is subordinate to the power of the directors to compromise the debt or to forfeit the stock of the stockholder for non-payment of his dues to the corporation; and that if the directors have, in good faith, and within such power as the law regulating the corporation gives them, declared all the stock of a member forfeited for non-payment of dues, he cannot be held liable as a stockholder for corporate debts.[3]

§ **1794. This Subject further Explained.**— Recurring, in this new connection, to what will be hereafter explained, and recollecting that the fact that the charter or statute under which a corporation is organized gives the corporation the right to declare the shares of a stockholder forfeited for non-payment of the assessments due thereon does not, in most of the States, deprive the corporation of the right to maintain an action against the stockholder on the contract of subscription,[4] we must conclude that the mere existence in the corporation of such a right is not

[1] Knight's Case, L. R. 2 Ch. 321. For further illustration of this principle see Woollaston's Case, 4 DeGex & J. 437 (reversing on this point Woollaston's Case, 5 Jur. (N. S.) 617; Lyster's Case, L. R. 4 Eq. 233 (forfeiture by a minority of the directors); King's Case, L. R. 2 Ch. 730, 735 (shares forfeited illegally subdivided); Webster's Case, 32 L. R. (Ch.) 135; Grady's Case, 1 De Gex & Sm. 488; Coleman's Case, *Id.* 495 (when forfeiture presumed). Compare Miller's Case, 3 Ch. Div. 661; *s. c.* 5 *Id.* 70. See *post*, § 1798.

[2] Allen *v.* Montgomery R. Co., 11 Ala. 437; Macauly *v.* Robinson, 18 La. An. 619.

[3] Mills *v.* Stewart, 62 Barb. (N. Y.) 444.

[4] *Ante*, § 1787.

a valid defense on the part of the stockholder against creditors of the corporation,[1] the power thus given to forfeit shares being merely a *cumulative remedy*.[2] Moreover, we shall see that in such cases the corporation has an election between two remedies: it may either declare a forfeiture, or it may bring an action at law for the amount due. If it declares a forfeiture, the relation between the shareholder and the corporation is thereby terminated and his contract of subscription cancelled; and neither the corporation[3] nor its creditors[4] can proceed against him for the remaining installments due under such contract.

§ 1795. **Further Explanations of the Principle.** — The rule that a forfeiture of shares terminates a stockholder's liability to creditors has been carried so far, in New York, as to hold that after forfeiture a stockholder is not liable for debts contracted while he was a stockholder.[5] Under the English Joint-stock Companies Acts a similar rule obtains. After the shares of a member have been forfeited by the directors, in pursuance of the terms of the deed of settlement, he cannot, in the event of

[1] Mann *v.* Currie, 2 Barb. (N. Y.) 294; Hightower *v.* Thornton, 8 Ga. 502; *s. c.* 52 Am. Dec. 412; Sagory *v.* Dubois, 3 Sandf. Ch. (N. Y.) 466.

[2] *Ante*, § 1784; Mann *v.* Currie, 2 Barb. (N. Y.) 294; McDonough *v.* Phelps, 15 How. Pr. (N. Y.) 372; Hightower *v.* Thornton, 8 Ga. 502; *s. c.* 52 Am. Dec. 412; Instone *v.* Frankfort Bridge Co., 2 Bibb, 577; *s. c.* 5 Am. Dec. 638; Tar River Nav. Co. *v.* Neal, 3 Hawks (N. C.), 520; Highland Turnpike Co. *v.* McKean, 11 Johns. (N. Y.) 98; Hartford &c. R. Co. *v.* Kennedy, 12 Conn. 499; Dutchess Cotton Man. Co. *v.* Davis, 14 Johns. (N. Y.) 238; *s. c.* 7 Am. Dec. 459; Herkimer Man. Co. *v.* Small, 21 Wend. (N. Y.) 273; Troy Turnpike Co. *v.* McChesney, 21 Wend. (N. Y) 296; Beene *v.* Cahawba &c. R. Co., 3 Ala. 660; Selma &c. R. Co. *v.* Tipton, 5 Ala. 789; *s. c.* 39 Am. Dec. 344; Gratz *v.* Redd, 4 B. Mon. (Ky.) 193; Goshen Turnpike Co. *v.* Hurtin, 9 Johns. (N. Y.) 217; *s. c.* 6 Am. Dec. 273; Troy &c. R. Co. *v.* Kerr, 17 Barb. (N. Y.) 581.

[3] Small *v.* Herkimer Man. Co., 2 N. Y. 330, overruling *s. c.* 21 Wend. (N. Y.) 273, and 2 Hill (N. Y.), 127; Andover &c. Turnpike Co. *v.* Gould, 6 Mass. 40; *s. c.* 4 Am. Dec. 80; Franklin Glass Co. *v.* White, 14 Mass. 286; Chester Glass Co. *v.* Dewey, 16 Mass. 94; *s. c.* 8 Am. Dec. 128; Ripley *v.* Sampson, 10 Pick. (Mass.) 371; Cutler *v.* Middlesex Factory, 14 Pick. (Mass.) 483; Mechanics' Foundry and Machine Co. *v.* Hall, 121 Mass. 272; Ashton *v.* Burbank, 2 Dill. (U. S.) 435; King's Case, L. R. 2 Ch. 714, 719, 731; Knight's Case, L. R. 2 Ch. 321.

[4] Allen *v.* Montgomery R. Co., 11 Ala. 450; Mills *v.* Stewart, 41 N. Y. 384 (Hunt, C. J., and Woodruff, J., dissenting), affirming *s. c.* 62 Barb. (N. Y.) 444; Macauly *v.* Robinson, 18 La. An. 619.

[5] Mills *v.* Stewart, 41 N. Y. 384.

the insolvency of the company, be put upon the list of contributories,[1] unless insolvency supervenes within one year after forfeiture, in which case, by the terms of the Companies Act, 1862,[2] he will be liable to contribute as a *past member*.[3]

§ 1796. Statutory Exceptions to This Rule. — To this rule there are exceptions, growing out of the provisions of statutes like the Railway Acts of Massachusetts, which expressly provide for a sale of shares by auction in case of non-payment of assessments, and that the shareholder shall be personally liable for the deficiency.[4]

§ 1797. Not so as to Ultra Vires Forfeitures. — If the charter or governing statute of a corporation, or in England the deed of settlement of a joint-stock company, does not authorize the board of directors to forfeit the shares of a member for a given cause or in a given manner, then a forfeiture for such cause or in such manner, will be set aside as *ultra vires*, and the shareholder will be put upon the list of contributories.[5] On this subject the established doctrine in England is said to be that where a joint-stock company is trading under a deed, shares can only be forfeited or transferred in the mode pointed out in the deed.[6] The English courts place this rule on the ground that

[1] Woollaston's Case, 4 De G. & J. 437; Beresford's Case, 2 Mac. & G. 197; Kelk's Case, L. R. 9 Eq. 107; Dawes' Case, L. R. 6 Eq. 232; Snell's Case, L. R. 5 Ch. 22.

[2] 25 & 26 Vict. c. 89, § 38. The statute reads: "In the event of a company formed under this act being wound up, every present and past member of such company shall be liable to contribute to the assets of the company, to an amount sufficient for payment of the debts and liabilities of the company, and the costs, charges, and expenses of the winding-up, and for the payment of such sums as may be required for the adjustment of the rights of the contributories amongst themselves, with the qualifications following (that is to say): 1. No past member shall be liable to contribute to the assets of the company if he has ceased to be a member for a period of one year or upwards prior to the commencement of the winding-up."

[3] Creyke's Case, L. R. 5 Ch. 63; Bridger's Case, L. R. 4 Ch. 266.

[4] Rev. Stat. Mass. 1836, ch. 39, § 53; Gen. Stat. Mass. 1860, ch. 63, § 9. See Lexington &c. R. Co. *v.* Chandler, 13 Metc. (Mass.) 311; Troy &c. R. Co. *v.* Newton, 1 Gray (Mass), 544.

[5] Dixon's Case, L. R. 5 Ch. 79; Spackman *v.* Evans, L. R. 3 H. L. 171; Stanhope's 1st Case, 3 De G. & Sm. 198.

[6] Beresford's Case, 3 De Gex & Sm. 175; *s. c.* 2 Mac. & G. 200, per Mr. Baron Rolfe, Ld. Comr. But this doctrine does not apply to a case where a party, holding what are inaccurately called shares, has never executed the deed, so as to be strictly a shareholder. *Ibid.*

such a forfeiture is a fraud upon the other members; the American courts place it upon the higher ground that it is a fraud upon creditors. Thus, in a leading case in the House of Lords upon this question, Lord Cranworth, after reciting the provisions of the deed of settlement of a joint-stock company giving the directors power to forfeit shares for non-payment of calls, said: "These provisions are strong to show that the power to declare shares forfeited was intended only to give to the directors additional means of compelling payment of calls, or other money due from the shareholder to the company by virtue of the deed. The shares are, in substance, made a security to the company for the money from time to time becoming due from the shareholder. The duty of the directors, when a call is made, is to compel every shareholder to pay to the company the amount due from him in respect to that call; and they are guilty of a breach of their duty to the company if they do not take all reasonable means for enforcing that payment. In the present case it has never been even suggested that the appellant was insolvent; that he was not perfectly able to pay the full 30*s.* per share, which was the amount of his call; and it was a plain breach of trust in the directors to take, in discharge of money due from the appellant, shares over which they had power as a security only for the money due, but which shares they knew to be valueless. They were bound, as trustees for the body of shareholders, to enforce payment of the whole 30*s.* per share, and for that purpose to take all proper legal proceedings, unless they *bona fide* believed that he was not in circumstances which would enable him to pay the sum for which he was sued; and there has never been even a suggestion that this was the case."[1] Further on, Lord Cranworth represents a shareholder, under such circumstances, as entitled to say: "I became a shareholder, relying on the names of those who were engaged with me in this partnership; I delegated the management to certain directors, with defined powers and duties; it was part of the stipulations of the deed of partnership that none of my fellow-shareholders should quit the partnership except by substituting in his place some other person approved by the directors; this was, I thought, a sufficient

[1] Spackman *v.* Evans, L. R. 3 H. L. 186.

security to me that, in the event of my being called on by a creditor, who having recovered judgment against the company, should proceed to enforce payment against me, I had solvent partners from whom I might obtain contribution; and now I find that, without any authority from me, you, the directors, have taken on yourselves to enable several of my partners to withdraw from the partnership by a proceeding which I never authorized."[1] Lord St. Leonards, in the same case, dismissed from consideration altogether any claim set up on the part of the creditors or the official manager in their behalf. In his opinion, the question was to be decided between the company and the retiring shareholder.

§ **1798. Effect of Acquiescence and Laches.** — These views are in strict accordance with the genius of the decisions of English chancery courts, under their various winding-up acts. An unlimited English joint-stock company, as already seen,[2] differs from an American corporation in respect of the fact that the former is nothing but a numerous partnership, each member being liable *in solido* for all the debts of the concern. As the persons who embark in such enterprises are generally solvent investors, the suggestion that creditors will fail of their dues is seldom met with; but, on the other hand, the courts hold that the primary object of their various winding-up acts is to secure contribution and equality among the shareholders *inter se*.[3] The other shareholders being, then, in the contemplation of the English courts, in general the only persons entitled to complain of the withdrawal of a member contrary to the terms of the deed of settlement, it follows that if, after knowledge of such a withdrawal, or circumstances which ought to charge them with knowledge, they stand by and do not complain, they should be taken as having acquiesced in it. This doctrine was agreed upon by the English equity judges and law lords with reference to what was known as the "Chippenham Compromise," entered into between some of the members of the Agriculturists' Cattle Assurance Company, who wished to retire from the company,

[1] *Ibid.* 190.

[2] *Ante*, § 14.

[3] This was at least so under the act of 1848. *Re* Phillips, 18 Beav. 629; *ante*, §§ 1520, 1572.

and others who wished to remain in it, whereby, by the payment of a certain assessment, those members who wished to do so were permitted by the directors to retire;[1] but in giving effect to it in Spackman's case, it was held, affirming the decision of Lord Chancellor Westbury,[2] and reversing that of the Master of the Rolls, that after the lapse of even twelve years all the shareholders were not to be deemed as having had notice of it and as having acquiesced in it, and the retiring shareholder was put upon the list of contributories.[3] The principle of course operates against the shareholder whose shares have been illegally forfeited, so as to bar him from relief against the forfeiture.[4]

§ 1799. Continued: The English Doctrine Stated.— The doctrine declared by these English authoritative cases may be thus stated:

1. A forfeiture by the directors of the shares of a member, not in accordance with the terms of the deed of settlement, is *ultra vires*, and voidable at the instance of a dissenting member.

2. But though thus voidable, if all the members had knowledge or sufficient means of knowledge of it, and acquiesced in it for a number of years, they will be deemed to have ratified it; and, in the event of the future insolvency of the company, the retiring member will not be put upon the list of contributories.

3. If, however, the forfeiture was *ultra vires*, and the proof does not raise a clear presumption of knowledge and acquiescence on the part of all the shareholders, in the event of subsequent insolvency, even after the lapse of several years, the retiring member will be put upon the list of contributories.

[1] Spackman *v.* Evans, L. R. 3 H. L. 171; Evans *v.* Smallcombe, L. R. 3 H. L. 249; Houldsworth *v.* Evans, L. R. 3 H. L. 263; Dixon's Case, L. R. 5 Ch. 79.

[2] 34 L. J. (Ch.) 321.

[3] Spackman *v.* Evans, L. R. 3 H. L. 249, Lords St. Leonards and Romilly dissenting.

[4] Rule *v.* Jewell, 18 Ch. Div. 660; Clegg *v.* Edmondson, 8 DeGex & M. 787. In Hart *v.* Clark, 6 DeGex M. & G. 232, *s. c.* 6 H. L. Cas. 633, and Clements *v.* Hall, 1 DeGex & J. 173, laches were held no bar. See also *ante*, § 1792.

4. If the pretended forfeiture is attended with circumstances of collusion and fraudulent concealment, no lapse of time will prevent a restoration of the retiring member to his liability as a contributory.[1]

[1] In the very elaborately discussed case of Spackman *v.* Evans, Lord Chancellor Westbury reversed the Master of the Rolls, and placed Spackman on the list of contributories, on the ground that it was a case of suppression, concealment, and fraud. 34 L. J. (Ch.) 321. On appeal, the Lords unanimously agreed that the forfeiture was *ultra vires*, but that it was not a case of suppression, concealment, or fraud; but they affirmed the decree of Lord Westbury, on the ground that the evidence did not show knowledge on the part of all the shareholders from which the House could infer a ratification of the act of the directors. The case in judgment cannot be better summarized than in the following head-note of the able official reporter of the House of Lords, Mr. Clark: "A joint-stock company was formed; a deed of settlement was executed, which had in it various clauses as to the admission and withdrawal of shareholders, and the transfer and forfeiture of shares. On difficulties arising in its business, a proposition was made to allow, on certain conditions, dissenting shareholders to retire on the forfeiture of their shares. This proposal, of which distinct notice had been given to all, was adopted at a public meeting of the shareholders. A shareholder who owned shares both by allotment and purchase, and who had executed the deed of settlement, dissented from these conditions, and sought by proceedings in chancery to have the company wound up. He was not successful in the attempt. An action was brought against him for overdue calls. He defended the action. After a time, and while the litigation with him was still going on, the directors entered into an agreement with him to allow him to retire, upon conditions which were not those named in the deed of settlement, nor in the proposal agreed to at the public meeting. No notice of these conditions thus entered into with this shareholder was shown to have been communicated to the other shareholders, but the fact of this shareholder's retirement was known to them, and there was no imputation of any fraudulent concealment. The name of the shareholder (who had performed all the conditions on which leave to retire was granted to him) was removed from the list of shareholders at the end of 1849. Changes were afterwards made in the mode of carrying on the company's business, and dividends were received; but he was not informed of the changes, he never received a dividend, and he never was called on to take, and never did take, any part in the affairs of the company. In 1861 the company was ordered to be wound up. *Held* (dissenting, Lord St. Leonards and Lord Romilly), that his name was rightly placed on the list of contributories." In Evans *v.* Smallcombe, L. R. 3 H. L. 249 (affirming Lord Romilly, Master of the Rolls, in L. R. 3 Eq. 769), the reporter summarizes the judgment of the Lords, as follows: "An arrangement [see the previous case] allowing members of a company to retire from the company, under certain conditions therein agreed to by a public meeting of the shareholders, convened after due notice to all the shareholders, is not in itself valid, unless made in accordance with the provisions of the

5. If, however, the declaration of forfeiture, though not strictly regular, complies substantially with the deed of settlement, the retiring member will not be put upon the list of contributories.[1]

§ 1800. Distinction between the American and English Cases. — The English courts, in their earlier cases, applied to persons whom creditors sought to charge as shareholders of such companies the familiar rule which obtains in other cases of partnership, namely, that a person who holds himself out to the public as a partner in a company, or who knowingly suffers himself to be

deed of settlement; and if not assented to, directly or indirectly, after due notice, by all the shareholders, may be impeached by any one of them. But if the means of notice to all appear sufficient, so as to raise a clear presumption of knowledge and acquiescence, and the arrangement is left unimpeached by any one for a great many years, the shareholder who has been allowed to retire, and whose name has been removed from the lists of the company, will be held to be relieved from his liability as a shareholder. (Dissenting, Lord Chelmsford.) The arrangement was, in this case, adopted and acted on, with this single exception, that the retiring shareholder did not at once pay the sum for which he was liable, but was allowed to give a bill for the amount, which bill was paid at maturity. The directors then passed a resolution declaring his shares cancelled, and his name was removed from the lists. *Held* (dissenting, Lord Chelmsford), that his name could not, after the lapse of years, be put upon the list of contributories." The reporter thus states the judgment of the Lords in Houldsworth *v.* Evans, L. R. 3 H. L. 263: "Where a general meeting of the shareholders of a company had agreed to certain conditions on which dissenting members were to be allowed to retire from the company, one of which fixed the date at which assent to the arrangement was to be declared; *held*, that that date was an essential part of the proceeding, and that the directors had no power, after the expiration of that date, to receive proposals and enter into arrangements with any member who desired to retire, but had not expressed his wish to do so within the stipulated time. But (per Lord Cranworth) where shareholders know that their directors have been exceeding their legal powers, and take no steps in the matter, but allow the things done to remain unimpeached for years. they must be taken to have retrospectively sanctioned what has been done."

[1] Woollaston's Case, 4 De G. & J. 437. As to what facts amount to an effectual forfeiture of shares, see Kelk's Case, L. R. 9 Eq. 107; Biggs' Case, L. R. 1 Eq. 309; Moore *v.* Rawlins, 6 C. B. (N. S.) 310. Where the articles of association made a shareholder liable, notwithstanding a forfeiture of his shares, to pay to the company all calls owing on such shares at the time of such forfeiture, this did not make him liable to pay *interest* on a call for which his shares had been forfeited. Stocken's Case, L. R. 3 Ch. 412.

so held out by others, is chargeable as a partner, in favor of any person who has given credit on the faith of his being such.[1] There were then two classes of shareholders: 1. Shareholders by *contract*, who were entitled to claim as against their co-shareholders the benefits accruing to them as such. 2. Shareholders by *conduct* or *estoppel*, who, while not entitled to claim the rights of shareholders as against the members of a company, were chargeable with the liabilities attaching to such a situation, in favor of its creditors. Little trace of this principle is found in the numerous cases which have arisen under the various acts for the regulation of joint-stock companies which have been in force in that country since 1844. The American courts, however, still proceed upon the theory that a person may become chargeable as a stockholder by conduct which has operated to deceive creditors, though not entitled to claim the rights of a stockholder as against the corporation or its members.[2] The English cases given in the preceding sections arose under the statutes named, and the American practitioner will be misled by them unless he bears clearly in mind the distinctive theories on which the English and American cases now proceed. There, although in some instances the doctrine is still recognized that a person may become a shareholder by *conduct*, though not such by *contract* with the company, that he will be estopped to deny that relation when to do so will prejudice creditors,[3] yet there is no contract between the creditors of the company and the shareholders; the contract of the creditor is with the company only; he can, in general, only claim to be paid out of the assets of the company, including *what the company have a right to bring into the assets.*[4] But in this country the broader and juster rule is more

[1] Pitchford *v.* Davis, 5 Mee. & W. 2; Fox *v.* Clifton, 6 Bing. 776; *s. c.* 9 Bing. 115; Dickinson *v.* Valpy, 10 Barn. & Cress. 141, per Parke, J.; *s. c.* 5 Man. & R. 126; Bourne *v.* Freeth, 9 Barn. & Cress. 632; *s. c.* 4 Man. & R. 572; Vice *v.* Lady Anson, 7 Barn. & Cress. 409.

[2] *Ante*, § 1438, *et seq. ante*, § 1590.

[3] Lord St. Leonards, in Spackman *v.* Evans, L. R. 3 H. L. 197; Lord Denman, C. J., in Cheltenham &c. R. Co. *v.* Daniel, 2 Ad. & El. (N. S.) 281; Taylor *v.* Hughes, 2 Jones & Lat. (Irish Ch.) 24; Bargate *v.* Shortridge, 5 H. L. Cas. 297; Henderson *v.* Royal British Bank, 7 El. & Bl. 356; Oakes *v.* Turquand, L. R. 2 H. L. 325. See *post*, § 1877, *et seq.*

[4] Smith's Case, L. R. 2 Ch. 604; Directors *v.* Kisch, L. R. 2 H. L. 99; Waterhouse *v.* Jamieson, L. R. 2 H. L. (Sc.) 29; Carling's Case, 1 Ch. Div. 115.

frequently applied, that although the subscription by the stockholder makes him a contractor with the corporation, upon the terms prescribed by the act creating it, yet this contract cannot be discharged or modified by consent of the contracting parties *where the rights of others will be prejudiced thereby*.[1]

§ **1801. Illustrations of Ultra Vires Forfeitures.** — Thus, a resolution or by-law allowing shareholders, on paying thirty per cent. of what was due on their subscriptions, to retire from the company, has been held void as to creditors.[2] And where the only creditor was a trustee of the corporation, and protested against such a resolution, though he accepted the money raised under it, and was present at a subsequent meeting when the application of the money was directed, to which he assented, this was held not a ratification by him of the by-law or resolution. But in this same case a by-law or resolution that any stockholder paying fifty per cent. on his shares should be discharged from all future calls on his subscription, other than proceeding by way of forfeiture, the sole creditor, himself a trustee, being present at the passage of the same, and consenting thereto, has been held valid; and those who complied with its terms before the dissolution of the corporation were held to be discharged from all responsibility to such creditor.[3] So, an arrangement made by the president of a corporation with a shareholder, to the effect that the latter should pay one-half of what was due on his subscription and be released as to the whole, was void as to creditors, and, the company becoming insolvent, its receiver maintained a bill for the unpaid balance.[4]

§ **1802. Collusive Forfeitures.** — Restating a doctrine already considered,[5] it is to be kept in mind that the power to forfeit can only be exercised for the *benefit of the company*, and never for the benefit of the shareholder. If therefore a shareholder procures his shares to be forfeited by the directors for the purpose of unloading the burden and escaping the liability which attends them, this will not discharge his liability to creditors in respect of them in case the company becomes in-

[1] Recognized in Allen *v.* Montgomery R. Co., 11 Ala. 450, and in Mills *v.* Stewart, 41 N. Y. 384. And see the following sections, where the American cases illustrating this doctrine are fully considered.

[2] Slee *v.* Bloom, 19 Johns. 456; *s. c.* 10 Am. Dec. 273.

[3] *Ibid.*

[4] Mann *v.* Cooke, 20 Conn. 178.

[5] *Ante*, § 1550.

solvent, but under English law he remains a contributory.[1] On the other hand, as Sir Nathaniel Lindley points out,[2] an *ultra vires* surrender of shares cannot be made valid by referring it to the power of forfeiture.[3] But this principle does not of course extend to the release of one who never was bound as a shareholder.[4]

§ 1803. Presumption that Stock was Regularly Forfeited. — Of course, as, under many charters and by-laws, the stock of corporations may be forfeited for the non-payment of dues to the corporation, if it appear that the stock of a particular shareholder was forfeited, the presumption is that it is regularly and lawfully forfeited; and no decree can be rendered against him, the effect of which is to charge him with liability as holder of such shares, unless it is first ascertained by judicial investigation whether the shares were properly forfeited or not.[5]

Article III. Relief Against Such Forfeitures

§ 1806. When Equity Will Relieve against Forfeiture. — The forfeiture of the shares of a member for non-payment of assessments lawfully made thereon, where the right of forfeiture exists, either under the charter or governing statute, or

[1] Richmond's Case, 4 Kay & J. 305; Stanhope's Case, L. R. 1 Ch. 161; Stewart's Case, *Id.* 511; Gower's Case, L. R. 6 Eq. 77.

[2] Lind. Comp. L. 5th ed. 845.

[3] Hall's Case, L. R. 5 Ch. 707; Ex parte Trading Co., 12 Ch. Div. 191.

[4] Lind Comp. L. 5th ed. 845; citing Goldsmid's Case, 16 Beav. 262; Coleman's Case, 1 De Gex. J. & S. 495; Belhaven's Case, 3 *Id.* 41. See also Dixon *v.* Evans, L. R. 5 H. L. 606 (reversing Dixon's Case, L.R. 5 Ch. 79).

[5] Lexington &c. R. Co. *v.* Bridges, 7 B. Monr. (Ky.) 556; *s. c.* 46 Am. Dec. 528. As to this presumption see Webster's Case, 32 L. J. Ch. 135; Grady's Case, 1 De Gex. J. & Sm. 488; Coleman's Case, *Id.* 495.

under a valid contract between the corporation and the shareholder, — do not fall within the category of forfeitures against which equity will relieve, in the absence of fraud, accident, or mistake.[1] It was so held where a stock certificate stipulated that it should be lawful for the holder either to pay assessments or not, but that the failure to pay any call, when due and payable, should be a relinquishment of the shares by the holder, and that time should be considered as of the essence of the contract. The reason was that upon such a forfeiture, the shares of the other stockholders become increased in value thereby, and this increase of value is then a *vested right*, of which they could not be divested without their consent, or without due process of law. Whether they did or did not sell or re-issue the forfeited stock, was deemed immaterial to its former owner.[2] But where the articles of association provided no mode in which a forfeiture of the shares of a member should be established, and where the mode pursued was a mere declaration by the trustees that the stock stood forfeited, and where there were other equitable circumstances in favor of the shareholder and he came in and tendered the whole amount due, principal and interest, — it was held that he should be allowed to redeem.[3] And in general it may be said that, while equity will not relieve a holder whose shares have been *duly forfeited*,[4] yet it will not interfere to prevent a forfeiture pending the settlement of a dispute between the company and the shareholder as to what is really due by the latter in respect of his shares;[5] and it will also restore to his rights as a shareholder one whose shares have been illegally forfeited.[6]

[1] Weeks *v.* Silver Islet &c. Mining Co., 23 Jones & Sp. (N. Y.) 1; *s. c.* 8 N. Y. St. Rep. 110.

[2] *Ibid.*

[3] Walker *v.* Ogden, 1 Biss. (U. S.) 289.

[4] Sparks *v.* Liverpool Waterworks Co., 13 Ves. 428.

[5] Naylor *v.* South Devon R. Co., 1 De Gex & Sm. 32. So it will see that he gets credit for what the shares would have brought if properly sold: Stubbs *v.* Lister, 1 Younge & C. 81.

[6] Stubbs *v.* Lister, *supra;* Hart *v.* Clarke, 6 De Gex M. & G. 232; *s. c.* 6 H. L. Cas. 633. See also Sweny *v.* Smith, L. R. 7 Eq. 324; Garden Gully Mining Co. *v.* McLister, 1 App. Cas. 39; Wood *v.* Wood, L. R. 9 Exch. 190. Ludlow *v.* Dutch &c R. Co., 21 Beav. 43; Naylor *v.* South Devon R. Co., 1 De Gex & Sm. 32; Pendergast *v.* Turton, 1 Younge & C. 98; Sparks *v.* Liverpool Waterworks, 13 Ves. 433; Germantown R. Co. *v.* Fitler, 60 Pa. St. 131; Small *v.* Herkimer Man.

§ 1807. No Relief Where Stockholder has Acquiesced until Change of Circumstances. — In conformity with principles already considered,[1] a stockholder cannot acquiesce in a forfeiture of his shares, so long as they remain valueless, and then, after they have become valuable by reason of some fortunate change of circumstances, claim the aid of a court of equity in re-instating him in his rights as a shareholder. This is well illustrated by a recent case where A. B. owned stock in a corporation which was sold in satisfaction of an assessment levied thereon, and purchased by the company. The stock had no market value, and after the sale, the company offered to return the stock to A. B., upon payment of certain advances made by the company, which he refused. Subsequently, the stock became valuable, by reason of the consolidation of the company with a rival corporation. It was held that A. B. could not then repudiate the sale, and come into a court of equity and claim an equivalent of the stock of the new company.[2]

§ 1808. No Relief Unless Stockholder Offers to Pay Up. — A bill in equity to obtain relief against a forfeiture of the plaintiff's shares in a corporation sustains an analogy to a *bill to redeem* land which has been forfeited under a common law mortgage. As is well known, the theory of such a mortgage was that the legal title passed to the mortgagee subject to a *defeasance*, — that is, subject to the right of the mortgagor to defeat it by paying, within the time named therein, a certain sum to the mortgagee. If this sum was not paid on or before the limited time, the title of the mortgagee became absolute. To remedy the hardship of estates being forfeited for debts much less than their value, the court of chancery interposed and permitted redemption, but only on condition of the payment of the debt within a time named. It was therefore necessary that a bill to redeem should show a willingness to pay the debt and interest for which, in theory of equity, the mortgagee stood as a mere security.[3] This principle must be of equal force where a

Co., 2 N. Y. 335. As to the effect of *delay* in seeking such relief, see *ante*, §§ 1792, 1798.

[1] *Ante*, §§ 1792, 1798.

[2] Sayre *v.* Citizens' Gas Light &c. Co., 69 Cal. 207; *s. c.* 10 Pac. Rep. 408.

[3] Walker *v.* Ogden, 1 Biss. (U. S.) 287.

shareholder whose shares have been forfeited for a failure to pay assessments made thereon, applies to a court of equity for relief against the forfeiture. Such relief can only be granted on the condition of his paying, or offering to pay, what is really due by him in respect of the shares. A court will not, therefore, grant an injunction to restrain a sale of corporate stock to satisfy a valid assessment merely because *notice* of the sale has been published an insufficient length of time, unless it appears that the stockholder has paid, or at least offered to pay, the amount of the assessments.[1]

§ 1809. No Relief against Forfeiture by Managers after Assignment for Creditors. — The charter of a railroad company provided that, if any stockholder should omit, for the space of six months, to pay any installment on his shares which might be called for, the managers of the company might declare such shares forfeited. The defendant, who was the owner of a certain number of shares in the company, paid two installments on his shares when called for. The company then made a general assignment for the benefit of its creditors; and a call for a third installment was made by the managers, without either the approval or disapproval of the assignee. The period of six months prescribed by the charter having elapsed without the payment of these assessments, the managers forfeited the defendant's shares. It was held that this was rightly done, and that a court of equity would not relieve him against the forfeiture.[2]

§ 1810. Injunction Granted against Forfeiture Where Shares are Paid in Full. — But where the directors make a call on the corporate stock, and threaten to forfeit, under the charter, the shares of those who refuse to respond, they will be enjoined from forfeiting such shares as have been paid in full.[3]

[1] Burham *v.* San Francisco Fuse Manuf. Co., 76 Cal. 26; *s. c.* 17 Pac. Rep. 940.

[2] Germantown &c. R. Co. *v.* Fitler, 60 Pa. St. 124; *s. c.* 100 Am. Dec. 546.

[3] Moore *v.* N. J. Lighterage Co., 23 N. Y. St. Rep. 213; *s. c.* 5 N. Y. Supp. 192.

CHAPTER XXIX.

ACTIONS BY THE CORPORATION AGAINST SHAREHOLDERS FOR ASSESSMENTS.

ARTICLE I. PARTIES.

§ 1815. **Action Brought in Corporate Name.** — As already seen,[1] one of the usual incidents of a corporation is the capacity to plead and be impleaded in its corporate name. An action by a corporation against one of its stockholders to recover an assessment against his subscribed stock, is therefore regularly brought in the corporate name,[2] — and this, although the contract may have been made with commissioners as public agents acting for the benefit of the intended corporation.[3] But, as already seen,[4] in some cases the trustees are the corporation, and when such is the case, they may bring an action in their own names alleging their corporate character.[5] Under some schemes of incorporation the

[1] *Ante*, § 1, *et seq.*

[2] Edinboro Academy *v.* Robinson, 37 Pa. St. 210; *s. c.* 78 Am. Dec. 421; *post*, § .

[3] Delaware &c. R. Co. *v.* Irick, 23 N. J. L. 321.

[4] *Ante*, § 16.

[5] Under a special act incorporating the Meadow Company, the trustees may declare, in their natural and official capacities, against members, for their proportion of expenses. Comfort *v.* Leland, 3 Whart. (Pa.) 81.

company is empowered to sue its shareholders in the name of one of its officers — called in England "its public officer."[1] Similar statutes have existed in this country. Under a banking law of the State of New York, such an action was properly brought in the name of the president of the corporation.[2] In South Carolina where, by the terms of the subscription paper, the installments were to be paid "to the treasurer of the company," an action was maintainable by any one who might be treasurer at the time the action was to be commenced.[3] In whatever way the action is brought, provided it be the authorized and proper way, the objection which is good where one partner sues another at law is, of course, not available; it is no objection that the defendant is a member of the plaintiff corporation or joint-stock company.[4]

§ 1816. Action in Original Name in Case of Change of Name. — Where subsequently to the subscription the name of the corporation has been changed, it is not a good defense that the action against the shareholder was brought by the corporation in its original name, instead of in the name conferred upon it by the supplemental act of the legislature, provided the *misnomer* had not been pleaded in *abatement*.[5] In so holding Gibson, C. J., made the following observations: "It was, indeed, said by Chief Justice Treby, in Britton *v.* Gradon,[6] that a judgment against a corporation by a wrong name is void; on which it is remarked in Kyd on Corporations, 285, that 'it is indeed true that in most of the cases where the question of misnomer of a corporation has been agitated, it has arisen on a special verdict; but I apprehend that where a corporation have

[1] Lind. Comp. 5th ed. 427. Chapman *v.* Milvain, 5 Exch. 61; Wills *v.* Sutherland, 4 Exch. 211; *s. c.* aff'd, 5 Exch. 715; Skinner *v.* Lambert, 4 Man. & Gr. 477; Lawrence *v.* Wynn, 5 Mees. & W. 355; Smith *v.* Goldsworthy, 4 Ad. & El. (N. S.) 430, where the action was brought in the name of the company. See also Welland R. Co. *v.* Blake, 6 Hurl. & N. 410. In English "cost-book" companies the purser can sue. St. 32 & 33 Vict. ch. 19, § 13.

[2] Stanton *v.* Wilson, 2 Hill (N. Y.), 153.

[3] Silk Co. *v.* Anderson, 1 McMull. (S. C.) 300.

[4] Willoughby *v.* Comstock, 3 Hill (N. Y.) 389.

[5] Gray *v.* Monongahela Nav. Co., 2 Watts & S. (Pa.) 156; *s. c.* 37 Am. Dec. 500, 504; *Ante*, §§ 289, 291, 400.

[6] 1 Ld. Raym. 119.

taken no advantage of a variance from their name, either by plea or at the trial, they cannot arrest the judgment on that account.' Surely the rule must be the same where the corporation is plaintiff. It seems, however, that if the variance be apparent in the entry of the judgment, it may be error; as in Healings *v.* The Mayor, Commonalty, and Citizens of London,[1] where the judgment was that the mayor, commonalty and citizens should recover their debt and costs to the same mayor and commonalty adjudged (omitting the word citizens), it was held error. But as there is no such discrepancy in the record before us, which contains but one designation of the plaintiff throughout, there is no room in the case even for this sharp distinction; and the exception that the court ought not to have rendered judgment on the verdict is not sustained." [2]

§ 1817. Authority of an Agent to Sue in the Corporate Name.— Where the subscriptions were in terms payable to the treasurer, and the directors voted that the treasurer be authorized to obtain the assistance of H. in making collections of the unpaid subscriptions, and afterwards voted that the treasurer be authorized to obtain such legal counsel as he should see fit as to such collections, this was held a sufficient authority for the institution of a suit by H, in the corporate name and behalf, against a subscriber to the capital stock.[3]

§ 1818. Actions by Assignee of Stock Subscriptions.— A corporation clothed with general powers to dispose of its securities or assets for the purpose of prosecuting the corporate enterprise, may sell, instead of endeavoring to collect, a subscription to its stock. And the title of the assignee will be protected, if acquired in good faith and for value, against a subsequent proceeding by garnishment against the company, even though no formal assignment in writing was ever executed.[4] And if the stock subscription is made upon a valid condition, and the

[1] Cro. Car. 574.

[2] Gray *v.* Monongahela Nav. Co., 2 Watts & S. (Pa.) 156; *s. c.* 37 Am. Dec. 500, 504. That a misnomer of a corporation plaintiff can be taken advantage of only by plea in abatement was held in Rheem *v.* Naugatuck Wheel Co., 33 Pa. St. 363, and in Fritz *v.* Commissioners, 17 *Id.* 135.

[3] Athol Music Hall Co. *v.* Carey, 116 Mass. 471. Compare Davis *v.* Smith American Organ Co., 117 Mass. 456.

[4] Morris *v.* Cheney, 51 Ill. 451.

assignee performs the condition, he may maintain an action against the subscriber to enforce the contract,—as in case of a subscriber to a railroad on condition of its being built on a certain route.[1] Where an insolvent corporation has made a deed of trust for the benefit of creditors, expressly assigning unpaid subscriptions, but giving no power to make calls for the unpaid balance of subscriptions, upon the failure of the president and directors to make proper assessments, it is the duty of a court of chancery to administer the remedy;[2] and, as hereafter seen,[3] the doctrine of equity is that, although a corporation may not have made such a voluntary assignment, yet a court of equity has power to collect the assets of the corporation and administer them for its creditors in the event of its insolvency, and, in so doing, to require the shareholders to pay into the court's receiver enough of their unpaid subscriptions for this purpose, and to empower its receiver to sue for the same at law; and the English courts proceed on the same principles, though under statutory rules, in winding up companies.[4]

§ **1819. By State Treasurer.** —A subscription authorized by the legislature, to raise a fund for the building of a state-house, by which the subscribers agree to pay into the treasury of the State the sums opposite their names, constitutes a simple contract obligation in favor of the State, and the State treasurer has been held the proper officer to sue therefor.[5]

§ **1820. Non-Joinder of Other Stockholders.** —As the obligation of each subscriber is *several* and *not joint*, so each must severally respond on his contract of subscription to the calls which are made upon him, without reference to the others; and hence where an action is brought upon such a call the non-joinder of the other stockholders is no defense or ground of exception, even where the suit, under a particular statute, is in equity,[6] or where the status of the subscriber is merely that of a partner in a joint-stock company.[7]

1 Smith *v.* Hollett, 34 Ind. 519.

2 Vanderwerken *v.* Glenn, 85 Va. 9; *s. c.* 13 Va. L. J. 91; 6 S. E. Rep. 806; 17 Wash. L. Rep. 86.

3 *Post*, §2960, *et seq.*

4 Lind. Comp. L. *passim.*

5 State Treasurer *v.* Cross, 9 Vt. 289; *s. c.* 31 Am. Dec. 626.

6 Baker *v.* Atkins, 62 Me. 205.

7 Haynes *v.* Kent, 8 La. An. 132.

Article II. Pleading.

§ **1823. Form of the Action.**— The action is, of course, an action at law,[1] as distinguished from a suit in equity; though in one State,[2] and possibly in others, the remedy is in equity.[3] Where the common law system of pleading prevails, the form of the action is usually *indebitatus assumpsit.*[4] It may be stated generally that an action of assumpsit at common law may be brought upon a contract of subscription to the stock of a corporation unless the bringing of such an action is impliedly or expressly inhibited by the act under which the plaintiff claims a corporate existence.[5] Where the subscription is made before the corporation comes into existence, there may be more difficulty in determining the form of the action at common law.[6] But it has been held in such a case, that if the corporation, relying upon the subscription, has expended money, it may maintain an action as for money laid out and expended, against such subscriber.[7] This action is to be distinguished from actions to charge stockholders for the benefit of creditors, where the remedy is often in equity.[8]

[1] Stokes *v.* Lebanon &c. Turnp. Co., 6 Humph. (Tenn.) 241.

[2] Baker *v.* Atkins, 62 Me. 205.

[3] *Post*, § 3428, *et seq.*

[4] Peake *v.* Wabash R. Co., 18 Ill. 88.

[5] Beene *v.* Cahawba &c. Co., 3 Ala. 660; Selma &c. R. Co. *v.* Tipton, 5 Ala. 787; *s. c.* 39 Am. Dec. 344; Instone *v.* Frankfort Bridge Co., 2 Bibb (Ky.), 576; *s. c.* 5 Am. Dec. 638; Taunton &c. Turnp. Corp. *v.* Whiting, 10 Mass. 327; *s. c.* 6 Am. Dec. 124; Essex Turnp. Corp. *v.* Collins, 8 Mass. 292.

[6] *Ante*, § 1162, *et seq.*

[7] Griswold *v.* Peoria University, 26 Ill. 41; *s. c.* 79 Am. Dec. 361.

[8] *Post*, § 3428, *et seq.*

§ 1824. Averments of the Declaration, Complaint or Petition.— The usual averments of a declaration, petition or complaint, in such an action, by whatever name called, are, first, a recitation of the terms of the contract of subscription, showing that the subscription was payable when called for by the directors, or otherwise as the case may be; followed by an averment that the call has been made accordingly and notice thereof given, and that the defendant has failed and refused to comply with the same. Thus, a complaint by a turnpike company to collect a stock subscription, which alleged that the same was "payable in such installments, and at such times as the company may direct;" that it had "ordered that the subscription be paid to the treasurer in three equal installments in thirty, sixty, and ninety days, from June 1, 1872;" and that it had demanded payment of the same, on April 1, 1874, with which demand the defendant had refused to comply,— was held sufficient in a jurisdiction where *notice* of the call is not required.[1] Unless the governing statute or the contract makes the subscription payable absolutely without call, an allegation that the directors have made *a call* is essential to a right of recovery, and an *answer* which denies that a call has been made is accordingly good on demurrer.[2] A declaration that made no reference to a written contract of subscription, and failed to aver any assessment or call by the directors, but averred that the subscription was payable in such manner and proportion and at such times as the directors should appoint,— was, of course, bad on demurrer.[3] Where the directors were authorized to receive subscriptions for the construction of the road as a whole, or for the construction of particular sections of it, a count on the *general subscription*, which averred a call made on the subscribers of the stock of a particular division was, of course, bad.[4] An averment that the *president and directors* made the assessment is tantamount to an averment that the corporation or company made it, and it is hence not a good ground of demurrer that the declaration fails to aver an assessment or call *by the company*. "This criticism,"

[1] Beckner *v.* Riverside &c. Turnp. Co., 65 Ind. 468.

[2] Mansfield &c. R. Co. *v.* Hall, 26 Ohio St. 311.

[3] McClasky *v.* Grand Rapids &c. R. Co., 16 Ind. 96.

[4] Tomlin *v.* Tonica &c. R. Co., 23 Ill. 429.

said the court, "ought not to prevail against the only practicable construction that can be given to the mode of executing the powers of this corporation. It is obvious that a company, in their collective capacity, can never act. The president and directors are their representatives, and they alone are authorized to manage the concerns of the company. The act invests them with this power, and it is thus set forth in the declaration. They alone could require the payment in question, and the order was properly made by them."[1]

§ **1825. Averment of Corporate Existence.**— The plaintiff must, of course, allege its own corporate existence, though this may be done in general terms.[2] In the view of one court the *complaint* must show that the company is authorized to have a capital stock and to receive such subscriptions.[3] Another court has held that it is not necessary to set out the *manner* of the organization of the plaintiff corporation, or its specific objects.[4] The same court has held that the certificate or articles of association should be filed with the complaint, and proper averments made, of the liability of each person whose signature appears thereto.[5]

§ **1826. Averment of the Existence of the Board of Directors.**— Where, by the terms of the subscription, an assessment can only be made by the board of directors, the *existence of the board of directors* need not, it seems, be strictly alleged; but it will be sufficient to aver "that the corporation was organized," and that the board of directors of said corporation made assessments, etc.[6]

§ **1827. Averment of Performance of Conditions Precedent.**— The declaration, petition, or complaint must show

[1] Union Turnpike Co. *v.* Jenkins, 1 Caines (N. Y.), 381, 391. As to the effect of the *Alabama* statute of Feb. 5, 1883, on the question of the averments in such a declaration, see Bolling *v.* Le Grand, 87 Ala. 482; *s. c.* 6 South. Rep. 332.

[2] It has been held in New Jersey that the act of incorporation should be set out in the declaration. Perdicaris *v.* Trenton &c. Bridge Co., 29 N. J. L. 367. But this is quite beyond what is generally required

[3] Minneapolis Harvester Works *v.* Libby, 24 Minn. 327.

[4] Williams *v.* Franklin &c. Assn., 26 Ind. 310.

[5] Herron *v.* Vance, 17 Ind. 595.

[6] Mississippi &c. R. Co. *v.* Gaster, 26 Ark. 455.

that all the requisities of the statute for the organization of the corporation have been complied with. Thus, if the statute of incorporation requires articles of association to be filed within the county where the company is organized, and a duplicate in the office of the Secretary of State, before it is pronounced incorporated,— the complaint must show that the duplicate was filed in the office of the Secretary of State.[1] But where the subscription to the capital stock of a railroad company was expressed to be for the purpose of extending the road, an averment in the declaration that the company was ready so to do, was not necessary.[2] But in general it may be said that, where the subscription is made prior to the organization of the corporation, and further acts are required by law as a condition precedent to the exercise of corporate powers, it is for the plaintiff to show that the requisite steps have been taken to complete the corporate organization.[3] Where the subscription to or purchase of the shares is upon a *condition* to be performed by the corporation, such as the president and directors have power to make, there is, of course, no binding contract on the part of the subscriber or purchaser, until the condition is fulfilled.[4] In such a case the corporation must, in order to recover, aver performance of the condition on its part. But one court perhaps went too far in holding that a complaint in such an action which does not aver that the company has issued, or offered to issue, the stock to the defendant, is insufficient.[5] Where the defendant subscribed to the capital stock of a proposed corporation, agreeing "to pay therefor two dollars in cash on each share, on or before January 25th, 1888, and the balance on each share at such times and in

[1] Nelson *v.* Blakely, 47 Ind. 38.

[2] New Albany &c. R. Co. *v.* Pickens, 5 Ind. 247.

[3] Williams *v.* Franklin &c. Association, 26 Ind. 310.

[4] McMillan *v.* Maysville &c. R. Co., 15 B. Mon. (Ky.) 218, 235; *s. c.* 61 Am. Dec. 181.

[5] St. Paul &c. R. Co. *v.* Robbins, 23 Minn. 439. The court reason that the contract is one of concurrent and dependent promises, and that neither party can require the other to perform, without performing, or offering to perform on his part. The certificate of stock, as already seen, is a mere symbol, and while valuable to the subscriber as an evidence of his right to his shares, and to enable him to transfer the same, is not at all necessary to his rights as a shareholder. *Ante,* § 1140. It is hence difficult to see how he can claim it until he has paid for his shares according to his contract.

such installments as the same shall be called for by said corporation," and the governing statute providing for the preliminary organization of corporations,[1] declared that "no such corporation shall transact business with any other than its members until at least one-half of its capital stock has been duly subscribed, and at least 20 per cent. thereof actually paid in," it was held that the corporation could not sue the defendant to recover an assessment made after the assessment of two dollars, without alleging that the above statutory requirement had been complied with.[2]

§ 1828. Such Averments not Necessary Where the Action is Brought on the Statute. — A declaration in an action of contract brought by a railroad corporation, which sets forth the defendant's written subscription for a certain number of shares in their stock, and the sale of such shares for non-payment of assessments, for less than enough to pay the same, and that the defendant owes them the amount of the deficiency, although it does not state that the defendant became a stockholder, has been regarded as a declaration upon the statute[3] and not upon the contract of subscription; from which the conclusion was reached that it need not aver performance of the conditions precedent of the contract.[4] And this was so, although the contract was inadvertently made a part of the record.[5]

§ 1829. Averment of Consideration. — It has been held that a note given by a subscriber to the stock of a corporation, promising to pay a certain sum per share for the number of shares of stock subscribed by him, in such manner and proportion, and at such time and place as should be determined by the president and directors and company, was not a *note-of-hand*, within the meaning of a statute permitting promissory notes to be declared upon without averment of consideration. It was not an absolute promise to pay, but the promise was uncertain and contingent; and therefore, in declaring upon it, it was necessary to set out the consideration by a sufficient averment. Nor was it sufficient that the shares of stock to which the defendant would be entitled

[1] Rev. St. Wis., § 1773.

[2] Anvil Mining Co. *v.* Sherman, 74 Wis. 226; *s. c.* 42 N. W. Rep. 226.

[3] Rev. St. Mass., ch. 39, § 53.

[4] Amherst &c. R. Co. *v.* Watson, 4 Gray (Mass.), 61.

[5] Troy &c. R. Co. *v.* Newton, 1 Gray (Mass.), 544.

were set forth in the declaration as descriptive of the extent of the promise, and as designating the amount which he undertook to pay, they not being set forth as the consideration of the promise.[1]

§ **1830. Averment of Notice of the Call.** — In those jurisdictions which adhere to the correct rule, that notice of the call is necessary before the subscriber can be regarded as in default,[2] it is necessary for the corporation to aver such notice in its declaration or complaint, in some sufficient form.[3] An averment of *notice* was held good, although it did not in terms aver that *due notice* had been given.[4]

§ **1831. What Instrument the Foundation of the Action.** — In an action for calls against shareholders who have subscribed preliminary articles of subscription, prior to or separate from the articles of association by which the corporation is formed, the instrument which constitutes the foundation of the action is not the articles of association, but the *contract of subscription*.[5] This constitutes the contract between the subscriber and the corporation; since, as elsewhere seen,[6] such subscriptions inure to its benefit when its organization is complete.[7]

[1] Union Turnpike Co. *v.* Jenkins, 1 Caines (N. Y.), 381, 394. That the payment of a *bill or note* must be absolute, and at all events independent of any uncertainty or contingency, see Kingston *v.* Long, 4 Doug. 9; Roberts *v.* Peake, 1 Burr. 323; Beardesley *v.* Baldwin, 2 Strange, 1151; Pearson *v.* Garrett, Comb. 227; Haydock *v.* Lynch, 2 Ld. Raym. 1563. But the distance of time at which the payment is to be made is immaterial, if it is to be made on an event which must necessarily happen; as six weeks after the death of the defendant's father. Cooke *v.* Colehan, 2 Strange, 1217. Within the meaning of this rule, events of a public nature for which the faith of the government is pledged, are deemed moral certainties, and hence not contingent, such as the paying off of a ship of war. Andrews *v.* Franklin, 1 Strange, 24; Evans *v.* Underwood, 1 Wils. 262.

[2] *Ante*, § 1747.

[3] Mississippi &c. R. Co. *v.* Gaster, 20 Ark. 455; *s. c.* 22 Ark. 361. Such was the early rule in Indiana, afterwards departed from in the era of railroad building. Corydon Steam Mill *v.* Pell, 4 Blackf. (Ind.) 472.

[4] Mississippi &c. R. Co. *v.* Turrentine, 21 Ark. 445; following Mississippi &c. R. Co. *v.* Gaster, *supra.*

[5] Heaston *v.* Cincinnati &c. R. Co., 16 Ind. 275; *s. c.* 79 Am. Dec. 430, 436.

[6] *Ante*, § 1170, *et seq.*

[7] Penobscot R. Co. *v.* Dummer, 40 Me. 172; *s. c.* 63 Am. Dec. 654; Tonica &c. R. Co. *v.* McNeely, 21 Ill. 71.

§ 1832. Filing the Paper which is the Foundation of the Suit. — Under the common law system of pleading, the plaintiff might make *profert* of the paper which was the foundation of the action, when the defendant craved *oyer* of the same. Modern codes of procedure dispense with this practice, by requiring the plaintiff either to file with the complaint the instrument itself or a copy thereof. This has given rise to the question in several cases, where the action was by a corporation against a subscriber to its stock to recover assessments, what paper, if any, should be filed, either in an original or in a copy. An early decision in Iowa required the plaintiff to annex a copy of the *subscription paper* to his petition.[1] The Supreme Court of Arkansas have held that it was not necessary for the plaintiff to make profert of the subscription paper, because that is not the foundation of the action.[2] Under the Missouri Code of Procedure[3] it is generally held that, if the plaintiff fails to make profert of the instrument of writing sued on, his petition will be bad on demurrer.[4] But where the suit is upon a subscription to the capital stock of a corporation, the rule does not, it seems, apply. The reason is that if such a paper must be filed in court in a suit against any one delinquent, and remain with the court during the pendency of the litigation, then but one suit could be prosecuted upon it at a time, and that one suit might be delayed so long in court that any action against the other delinquents would become

[1] Hudson *v.* Plank Road &c. Co., 4 Greene (Iowa), 152.

[2] Mississippi &c. R. Co. *v.* Gaster, 20 Ark. 455.

[3] The statute referred to reads as follows: "When any petition, or other pleading, shall be founded upon any instrument of writing charged to have been executed by the other party, or his testator or intestate, or other person represented by such party, and not therein alleged to be lost or destroyed, the same shall be filed with such petition, or other pleading." G. S. Mo. 1865, p. 662, § 51; 2 Wag. Stat., p. 1022, § 51; R. S. Mo. 1879, § 3560. The danger of valuable instruments of writing being lost or stolen, when filed with the petition in a case, seems not to have been considered by the authors of this code; but, with this danger in view, the authors of the last revision amended the statute so as to allow the filing of a copy, unless the court should, on good cause shown, require the production of the original. Mo. Rev. Stat. 1889, § 2088. Many decisions in that State have been made, dispensing with the strict requirements of this statute, which will be rendered obsolete by this amendment.

[4] McCormick *v.* Kenyon, 13 Mo. 131; Campbell *v.* Wolf, 33 Mo. 459; Dyer *v.* Murdock, 38 Mo. 224; Carr *v.* Waldron, 44 Mo. 393; Workman *v.* Campbell, 46 Mo. 305.

barred by limitation. Moreover, the subscribers might reside in different counties; and hence, an enforcement of the rule in such suits would amount, practically, to a denial of the processes of the law in the enforcements of such contracts.[1]

§ 1833. Instances of a Good Complaint where the Subscription is Made Prior to Organization. — A complaint in substance as follows, has been held a good complaint: It alleged that the defendant and others entered into an agreement with J., in contemplation of the organization of the corporation for manufacturing purposes, and subscribed certain sums to constitute the capital stock thereof; that in pursuance of the agreement, the corporation was thereafter duly organized by the defendant and the other subscribers to the agreement; that the stock subscriptions were thereupon duly transferred to the corporation; that all the terms and conditions of the agreement had been fulfilled; that calls had been duly made for the payment of such subscriptions, and due notice given to the defendant to pay the same, in accordance with the terms thereof, prior to the commencement of the action.[2]

§ 1834. Averments to Show Federal Jurisdiction.— A corporation is a "citizen" within the provision of the thirteenth section of the Judiciary Act relating to the jurisdiction of the Federal Courts, and it is, for the purposes of the jurisdiction of the Federal courts, a citizen of the State by whose laws it is created. If the action is brought in a Circuit Court of the

[1] It was so held in Workman *v.* Campbell, 46 Mo. 305, where the account was upon a subscription to pay a person therein named a eertain sum of money to be used in securing the location of a railroad depot at a place named. It was also held, construing a similar statute relating to proceedings before justices of the peace, where the contract sued on was a subscription to the capital stock of a corporation. Hannibal &c. Plank Rd. Co. *v.* Robinson, 27 Mo. 396. That the *resolution* of the board of directors, declaring that an assessment shall be made, is not the written instrument which the statute of Indiana requires to be filed in such an action, see Van Riper *v* American Central Ins. Co., 60 Ind. 123.

[2] Minneapolis Threshing-Machine Co. *v.* Crevier, 39 Minn. 417; *s. c.* 40 N. W. Rep. 507. For a precedent of a good complaint where the corporation *assigned the stock subscription* and gave the assignee a written order on the subscriber for the same, which the subscriber accepted — see Stockton *v.* Creager, 51 Ind. 262. As to what averments of the payment of the required *deposit* (*ante*, § 1216) will be accepted as sufficient, see Highland Turnp. Co. *v.* McKean, 11 Johns. (N. Y.) 100. See also Grayble *v.* York &c. Co., 10 Serg. & R. (Pa.) 269.

United States, it is necessary to aver in the declaration, in order to show jurisdiction in the court, that the plaintiff is a corporation *created by the laws* of a particular State, therein named, other than the State in which the action is brought.[1]

§ **1835. Plea — Answer.**—Defensive matter available by plea or answer cannot, of course, be taken advantage of for the first time in an appellate court, — as that, by the terms of the contract, the directors could assess the defendant only $25 a share at a time, and the assessment sued for was $42.[2]

ARTICLE III. MISCELLANEOUS.

§ **1838. Suing for Too Much and Recovering What is Due.** — There is no principle of procedure which turns the plaintiff out of court merely because he sues for *too much*. It has accordingly been held, in an action to recover the whole amount of a subscription payable in installments, that the company may recover an installment payable without any proviso or condition, though it should fail in proving the right to the other installments.[3] And so, where several assessments have been made, the directors may *waive* or *abandon* one that is void, and sue for those that are valid.[4]

§ **1839. Instructions: Facts Essential to a Recovery must be Submitted to the Jury.** — Under the theory of the independ-

[1] Marshall *v.* Baltimore &c. R. Co., 16 How (U. S.) 314; Pennsylvania *v.* Quicksilver Co., 10 Wall. (U. S.) 553. Compare Ohio &c. R. Co. *v.* Wheeler, 1 Black (U. S.), 286; Louisville R. Co. *v.* Letson, 2 How. (U. S.) 497; Insurance Co. *v.* Francis, 11 Wall. (U. S.) 210; Steamship Co. *v.* Tugman, 106 U. S. 118; Muller *v.* Dows, 94 U. S. 444.

[2] Eastern Plank Road Co. *v.* Vaughan, 20 Barb. (N. Y.) 155.

[3] St. Louis &c. R. Co. *v.* Eakins, 30 Iowa, 279.

[4] Read *v.* Memphis &c. Gas Co., 9 Heisk. (Tenn.) 545

ence of juries which obtains in Maryland, it is held that, in an action by a corporation to recover subscriptions to its stock, an instruction that, upon the finding of certain facts, the plaintiff is entitled to recover, but omitting the material fact of the proceedings of the corporation calling for the installments and notice to the defendant of these calls, is erroneous; no matter how clear the evidence may have been to prove these omitted facts, it was necessary for the jury to pass upon it.[1] This view of the independence of juries is that the court cannot direct a verdict in favor of the party who sustains the burden of proof, unless the facts are conceded by the opposite party: it is for the jury to say whether or not they will believe the evidence offered to establish the facts, although no countervailing evidence may have been offered.

§ 1840. Effect of Changes Pending Such Actions. — Where the theory has been adopted that a failure to pay the statutory *deposit* avoided the subscription,[2] and to obviate this, a statute was passed, while a suit against a subscriber was pending, enacting that corporations should have the same remedy for the recovery of subscriptions as if former statutes had not required payment at the time of subscribing, — it was held not to cure the defect in the contract so as to help out existing actions.[3] Such an action is not defeated by the fact that, pending it, the plaintiff has *consolidated* with another company and thereby ceased to exist. The cause of action has not died, but has passed to a new company. If this is a valid objection in any form, it must be considered matter in abatement merely, and be pleaded *puis darrein continuance*.[4]

§ 1841. Indexes to Miscellaneous Matters. — Statutes of Maine held not to empower the corporation to enforce assessments upon a person who had not concurred in procuring the charter.[5] - - - - Judgment against a defaulting stockholder, without appearance and process, not authorized by section 11 of the charter of Wilmington and

[1] Maltby *v.* North Western &c. R. Co., 16 Md. 422.

[2] *Ante*, § 1216, *et seq.*

[3] Ogle *v.* Somerset &c. Turnpike Co., 13 Serg. & R. (Pa.) 256.

[4] Swartwout *v.* Michigan &c. R. Co., 24 Mich. 389; *ante*, § 343, *et seq.*

[5] Richmond Factory Association *v.* Clarke, 61 Me. 351.

Raleigh Railroad company.[1] - - - Colorado statute (Gen. St. Colo. § 241) amended with reference to the recovery of the balance of unpaid subscriptions, etc.[2] - - - - A discussion of the liability of stockholders to assessments, with a collection of American cases, will be found in a note in 4 L. R. A. 232.[3] - - - - In view of the Alabama "stay-law" of Feb. 8, 1851, a corporation, whose act of incorporation gives it a summary remedy by notice and motion against delinquent stockholders, is not entitled to judgment at the return term of the notice, although said act so provides.[4]

1 Wilmington &c. R. Co. *v.* Baker, 3 Dev. & B. (N. C.) 79.

2 Colo. Act, Feb. 20, 1889, L. 1889, p. 96.

3 See Young *v.* Erie Iron Co., 65 Mich. 111.

4 Exp. Northeast &c. R. Co., 37 Ala., 679.

CHAPTER XXX.

EVIDENCE IN SUCH ACTIONS.

ARTICLE I. EVIDENCE OF CORPORATE EXISTENCE.

§ 1846. Evidence of the Existence of the Corporation.— This brings us to a question more extensively considered in its general bearings elsewhere,[1] namely, in what manner the existence of the corporation is *proved* in actions of this nature. It may be stated generally, that if the defendant, when sued by the alleged corporation, files a plea in the nature of a common law plea of *nul tiel corporation*, the production of the certificate of incorporation which has been filed, and proof of *user*, and possibly proof of user alone, will be sufficient evidence, *prima facie*, of the fact that it is a corporate body in fact as well as in name.[2] We have also seen that the ordinary proof of a corporation which is created by a special charter is the production of the charter and evidence of user thereunder.[3] Moreover, the existence *de jure* of a corporation is often proved by *legislative recognition;*[4] and where the legislature of a State has full power to create corporations, its act recognizing as valid a *de facto* corporation, whether private or municipal, operates to cure all defects in steps leading up to the organization, and makes a *de jure* out of what was before only a *de facto* corporation.[5] Again, the recitals in the subscription paper may *estop* the subscriber. The signature to a subscription for stock in an alleged railroad corporation, which recited that a company had been formed under the general act, and that the articles of association, with the necessary affidavits,

[1] *Ante*, § 495, *et seq.; post*, Ch. 184.

[2] Gray, J., in Eaton *v.* Aspinwall, 19 N. Y. 121; Snow *v.* Peacock, 2 Car. & P. 215; Dutchess Cotton Man. Co. *v.* Davis, 14 Johns. (N. Y.) 238, 245; *s. c.* 7 Am. Dec. 459; United States Bank *v.* Stearns, 15 Wend. (N. Y.) 315; Utica Ins. Co. *v.* Tillman, 1 Wend. (N. Y.) 566; Sampson *v.* Bowdoinham Steam Mill Corp., 36 Me. 78; Methodist Episcopal, Church *v.* Pickett, 19 N. Y. 482; Searsburg Turnpike Co. *v.* Cutler, 6 Vt. 315, 323.

[3] *Ante*, § 497. Thus, in an action against a subscriber to the stock of a railroad company on a bond for the payment of an installment of such stock, it was held that evidence of the existence of a president and an engineer, acting and purporting to act for and in behalf of the corporation, and a charter authorizing the appointment of such officers, were sufficient to establish its organization as against the defendant and all others dealing and treating with them in their corporate capacity Wilmington &c. R. Co. *v.* Thompson, 7 Jones L. (N. C.) 387. See also Bank of U. S. *v.* Stearns, 15 Wend. (N. Y.) 314; Methodist &c. Church *v.* Pickett, 19 N. Y. 482.

[4] *Ante*, § 512.

[5] Commanche County *v.* Lewis, 133 U. S. 198; *s. c.* 33 L. ed. 604; 10 Sup. Ct. Rep. 286.

had been duly filed, was deemed *conclusive evidence* of an incorporation against the subscriber.[1] Before the principle of *estoppel*, more extensively considered hereafter, became established, *letters-patent* from the governor, issued in pursuance of an act of incorporation, were held sufficient evidence of the existence of the corporation to enable it to maintain such an action.[2] In Illinois, *articles of association*, certified by the Secretary of State, are *prima facie* evidence as to the amount of capital stock that has been subscribed.[3]

§ **1847. Burden of Proof.** — Where the action is brought by the corporation for assessments, or by or on behalf of creditors of the corporation, the burden of proof will depend not only upon the nature of the issue as raised by the pleadings, but also upon the view which the court in the particular jurisdiction may take of the questions discussed in the succeeding sections. Where the governing statute makes certain formalities *prima facie* evidence of a due organization, and those formalities appear, the burden of showing defects rests upon those who challenge the corporate existence.[4]

§ **1848. Corporate Existence Admitted by Pleading the General Issue.** — There is a rule of procedure, extensively acted upon,[5] that in an action by an alleged corporation, if the defendant pleads the general issue at common law, or the *general denial* under the codes, he thereby admits the legal capacity of the

[1] Black River &c. R. Co. *v.* Clarke, 25 N. Y. 208.

[2] Grubb *v.* Mahoning Nav. Co., 14 Pa. St. 302. So held in regard to letters-patent of the governor of Pennsylvania, in respect of a corporation created by an act of the legislature of that State, in Wellersburg &c. Plank Road Co. *v.* Young, 12 Md. 476.

[3] Jewell *v.* Rock River Paper Co., 101 Ill. 57.

[4] Thus, under a statute of Connecticut making a certified copy of the original certificate of organization of any joint-stock corporation *prima facie* evidence of the due formation, existence, and capacity of such corporation (Gen. Stat. Conn., p. 439, § 23), where the stockholders, after the filing of the certificate of organization, seek to take advantage of any defect in the organization, in a suit against the corporation upon its contracts, the burden of showing any defect rests upon them. Wood *v.* Wyley Const. Co., 56 Conn. 87; *s. c.* 13 Atl. 137; 5 New Eng. 921.

[5] *Post*, Ch. 184, Art. II.

plaintiff to sue; and this rule has been held to obtain in an action by a corporation upon a subscription to its stock.[1]

§ 1849. No Defense that Corporation not Legally Organized. — The general rule is that the subscriber cannot, when sued by the corporation to enforce his contract of subscription, set up as a defense an irregularity in the organization of the corporation;[2] and the same rule obtains where the action is brought by or on behalf of *creditors* of the corporation.[3] So, in an action by an *insolvent corporation* to collect an assessment for the purpose of paying their debts, the interests of the creditors will be so far regarded that no defense grounded on defects in the organization of the corporation can be maintained, unless it could have been successfully set up in answer to a creditor's bill against the stockholders to enforce their personal liability.[4]

Rockland &c. Steamboat Co. *v.* Sewall, 78 Me. 167; *s. c.* 3 Atl. Rep. 181; 1 New Eng. Rep. 791; 4 East. Rep. 621; Kenton &c. Co. *v.* McAlpin, 5 Fed. Rep. 741. A plea of the general issue admits the competency of the plaintiff to sue as a corporation. Society for the Propagation of the Gospel *v.* Town of Pawlet, 4 Pet. (U. S) 480. But it admits that fact only; it does not admit that it was organized under a certain law, but the plaintiff, a creditor suing a stockholder, must prove such fact. Gay *v.* Keys, 30 Ill. 413, 421. In a suit against a shareholder by an assignee in bankruptcy of the corporation, a plea of the general issue admits the existence of the corporation. Pullman *v.* Upton, 96 U. S. 328.

[2] Schenectady &c. R. Co. *v.* Thatcher, 11 N. Y. 102; Goodrich *v.* Reynolds, 31 Ill. 490; *s. c.* 83 Am. Dec. 240; Patterson *v.* Wyomissing &c. Co., 40 Pa. St. 117; Eaton *v.* Aspinwall, 19 N. Y. 119; *s. c.* 6 Duer (N. Y.) 676; 3 Abb. Pr. (N. Y.) 417; Central Plank Road Co. *v.* Clemens, 16 Mo. 365; Home Stock Ins. Co. *v.* Sherwood, 72 Mo. 461; Edinboro Academy *v.* Robinson, 37 Pa. St. 210; *s. c.* 78 Am. Dec. 421; East Pascagoula Hotel Co. *v.* West, 13 La. An. 545; Cayuga Lake R. Co. *v.* Kyle, 64 N. Y. 185; Wight *v.* Shelby R. Co., 16 B. Monr. (Ky.) 4; *s. c.* 63 Am. Dec. 523; Hughes *v.* Bank of Somerset, 5 Litt. (Ky.) 45; Swartwout *v.* Michigan &c. R. Co., 24 Mich. 389; Monroe *v.* Fort Wayne &c. R. Co. 28 Mich. 272; Rockville &c. R. Co. *v.* Van Ness, 2 Cranch C. C. (U. S.) 449. See note, 19 Am. & Eng. Corp. Cas. 298; Central &c. Assn. *v.* Alabama Gold &c. Co., 70 Ala. 121; Buffalo &c. R. Co. *v.* Cary, 26 N. Y. 75.

[3] McDonnell *v.* Alabama Gold Life Ins. Co., 85 Ala. 401; *s. c.* 5 South. Rep. 120; Baker *v.* Backus, 32 Ill. 79; Booth *v.* Campbell, 37 Md. 522; Upton *v.* Hansbrough, 3 Biss. (U. S.) 417; Chubb *v.* Upton, 95 U. S. 665; Methodist &c. Church *v.* Pickett, 19 N. Y. 482; Slocum *v.* Providence &c. Co., 10 R. I. 112. But see Heard *v.* Sibley, 52 Ga. 310.

[4] Ossipee Manf. Co. *v.* Canney, 54 N. H. 295.

1850. Provided there is a Corporation de Facto. — Many of the cases qualify this rule with the proviso that there is a corporation *de facto*, though informally[1] or even illegally[2] organized. The doctrine is universally settled that a corporation may exist *de facto*, though not *de jure*. It may have an existence which will be perfectly valid in so far as the rights of third persons are concerned, but which nevertheless cannot be maintained against the State. That is, it may exist so long as the State acquiesces and does not institute proceedings to oust it.[3] But, as there can be no *de facto* officer where there is no office to fill,[4] so there can be no *de facto* corporation where the pretended corporation is one which the law does not authorize to exist at all, but one the existence of which it prohibits. Accordingly, the reasoning is that, when it is shown that a *charter has been granted*, then those in possession and actually exercising the corporate rights will be considered as rightfully there, against wrong-doers, and against all those who have treated or acted with them in their corporate character; that the sovereign alone has a right to complain, since, if it is an usurpation, it is upon his rights, and his acquiescence is evidence that all things have been rightfully performed.[5] And the same reasoning would apply where there is a *general law* authorizing the organization of such a corporation as the one which brings the action. In short, this principle may be invoked against one who has subscribed for stock in a body which has *attempted irregularly* to create itself a corporation.[6]

§ 1851. Theories as to What is Necessary to Constitute a Corporation de Facto. — "In order to establish such a corpo-

[1] Montpelier &c. R. Co. *v.* Langdon, 46 Vt. 284; Monroe *v.* Fort Wayne &c. R. Co., 28 Mich. 272; Swartwout *v.* Michigan &c. R. Co., 24 Mich. 389.

[2] Eaton *v.* Aspinwall, 19 N. Y. 121.

[3] Central Ag. &c. Asso. *v.* Alabama &c. Co., 70 Ala. 120; *s. c.* 9 Am. Corp. Cas. 8, 13; Lehman *v.* Warner, 61 Ala. 455; *s. c.* 6 Am. Corp. Cas. 155. See also Baker *v.* Backus, 32 Ill. 79.

[4] Jester *v.* Spurgeon, 27 Mo. App. 477.

[5] Tar River Nav. Co. *v.* Neal, 3 Hawks (N. C.), 537; Elizabeth City Academy *v.* Lindsey, 6 Ired. L. (N. C.) 476; *s. c.* 45 Am. Dec. 500. To the same effect see Wilmington &c. R. Co. *v.* Saunders, 3 Jones L. (N. C.) 126; Atlantic &c. R. Co. *v.* Johnston, 70 N. C. 350.

[6] Chubb *v.* Upton, 95 U. S. 667, per Mr. Justice Hunt.

ration, it is necessary to show user of the corporate franchise by an association of persons, though the organization may be so defective as to render the franchise wholly invalid in a proceeding against it by the State; or, in other words, it is necessary to show the existence of a charter, or some law under which the assumed powers are claimed to be conferred, and the user of the franchise claimed under such charter or law."[1] In another case it is said: "If the papers filed, by which the corporation is sought to be created, are colorable, but so defective that, in a proceeding on the part of the State against it, it would for that reason be dissolved, — yet, by acts of user under such an organization, it becomes a corporation *de facto*, and no advantage can be taken of such defect in its constitution, collaterally, by any person."[2]

§ **1852. Validity of Organization Questionable only by the State.** — With this qualification, either expressed or tacitly implied, the courts reason that the validity of the organization of the corporation can be questioned only in a direct proceeding against the corporation by the State.[3]

§ **1853. Stockholder Estopped to Deny It.** — Many of the cases rest the same conclusion on the ground that the stockholder is *estopped* by his conduct from denying the fact of the regularity or legality of the organization of the corporation.[4]

[1] Gantt, J., in Abbott *v.* Omaha Smelting &c. Co., 4 Neb. 416, 420.

[2] Buffalo &c. R. Co. *v.* Cary, 26 N. Y. 77; quoted with approval in Abbott *v.* Omaha Smelting &c. Co., 4 Neb. 416, 420. See *ante*, § 495, *et seq.*, and especially § 501.

[3] Hughes *v.* Bank of Somerset, 5 Litt. (Ky.) 45; Appleton &c. Ins. Co. *v.* Jesser, 5 Allen (Mass.), 446; Swartwout *v.* Michigan &c. R. Co., 24 Mich. 389; Chester Glass Co. *v.* Dewey, 16 Mass. 94; *s. c.* 8 Am. Dec. 128; Selma &c. R. Co. *v.* Tipton, 5 Ala. 787; *s. c.* 39 Am. Dec. 344; Rice *v.* Rock Island &c. R. Co., 21 Ill. 93; Goodrich *v.* Reynolds, 31 Ill. 490; *s. c.* 83 Am. Dec. 240; Eaton *v.* Aspinwall, 19 N. Y. 122; Buffalo &c. R. Co. *v.* Cary, 26 N. Y. 75.

[4] Chester Glass Co. *v.* Dewey, 16 Mass. 94; *s. c.* 8 Am. Dec. 128; Selma &c. R. Co. *v.* Tipton, 5 Ala. 787; *s. c.* 39 Am. Dec. 344; Eaton *v.* Aspinwall, 19 N. Y. 119; Mead *v.* Keeler, 24 Barb. (N. Y.) 20, 25; Ferguson *v.* Landram, 5 Bush (Ky.), 230; *s. c.* 96 Am. Dec. 350; Tarbell *v.* Page, 24 Ill. 46; Parker *v.* Northern Cent. Mich. R. Co., 33 Mich. 23; McCune Mining Co. *v.* Adams, 35 Kan. 193; Buffalo R. &c. Co. *v.* Cary, 26 N. Y. 75; Rice *v.* Rock Island, &c. R. Co. 21 Ill. 93; Casey *v.* Calli, 94 U. S. 674; Abbott *v.* Aspinwall, 26 Barb. (N. Y.) 202; Holyoke Bank *v.* Goodman &c. Co., 9 Cush.

This estoppel arises in three ways: 1. Where the corporation was in pretended existence at the time when the subscription was made, and the subscriber contracted with it in its corporate name, and thereby recognized its corporate existence, within the meaning of a rule hereafter discussed,[1] — as, for instance, where the subscriber executed his note to the corporation for his subscription, using its corporate name as payee,[2] especially if the note has been *assigned* by the corporation to a third person.[3] The rule under this head is not confined to actions by the corporation against its own stockholders to enforce their contracts of subscription; but it extends to any case of an action by a corporation against any one who has contracted with the corporation in its corporate name, and it may be stated thus: A person who has *contracted with* a body in writing, by a corporate name, when sued upon the instrument in the same name, is estopped to deny that the payee or obligee is such a corporation.[4] 2. Where the subscriber has participated in the organization of the corporation, in its meetings, in its business, or has otherwise acted in reference to it in virtue of being a stockholder,[5] — in which case, as already seen,[6] the estoppel extends so far as to

(Mass.) 576; McHose *v.* Wheeler, 45 Pa. St. 32; Lane *v.* Brainard, 30 Conn. 565.

[1] *Post,* Ch. 184; Dutchess Cotton Manufactory *v.* Davis, 14 Johns. (N. Y.) 238; *s. c.* 7 Am. Dec. 459.

[2] Lucas Market Savings Bank *v.* Goldsoll, 8 Mo. App. 596.

[3] Goodrich *v.* Reynolds, 31 Ill. 490; *s. c.* 83 Am. Dec. 240.

[4] Rice *v.* Rock Island &c. Co., 21 Ill. 95; Goodrich *v.* Reynolds, 31 Ill. 490; *s. c.* 83 Am. Dec. 240; Dutchess Cotton Man. *v.* Davis, 14 Johns. (N. Y.) 238, 245; *s. c.* 7 Am. Dec. 459; Hamtramck *v.* Bank of Edwardsville, 2 Mo. 169; Hughes *v.* Bank of Somerset, 5 Litt. (Ky.) 45, 46; Tar River Nav. Co. *v.* Neal, 3 Hawks (N. C.), 520, 536; Worcester Medical Inst. *v.* Harding, 11 Cush. (Mass.) 285, 289; Brookville Turnpike Co. *v.* McCarty, 8 Ind. 392. On the question of *estoppel* see the following analogous decisions: Bidwell *v.* Pittsburgh, 85 Pa. St. 412; *s. c.* 27 Am. Rep. 662, and cases cited; Petition of Sharp, 56 N. Y. 257; *s. c.* 15 Am. Rep. 415; Burlington *v.* Gilbert, 31 Ia. 366; *s. c.* 7 Am. Rep. 143.

[5] See Dutchess Cotton Man. Co. *v.* Davis, 14 Johns. (N. Y.) 232; *s. c.* 7 Am. Dec. 459; Clark *v.* Navigation Co., 10 Watts (Pa.) 364; Centre Turnp. Co. *v.* McConaby, 16 Serg. & R. (Pa.) 140; Sheffield &c. R. Co. *v.* Woodcock, 7 Mees. & W. 578; Chittenham *v.* Railway Co., 2 Ad. & El. (N. S.) 281; Selma &c. R. Co. *v.* Tipton, 5 Ala. 787, 807; *s. c.* 39 Am. Dec. 344; Central Plank Road Co. *v.* Clemens, 16 Mo. 359; Hunt *v.* Kansas & Missouri Bridge Co., 11 Kan. 412; Cabot Bridge *v.* Chapin, 6 Cush. (Mass) 50.

[6] *Ante,* §§ 82, 1228, 1297, 1323, 1337, 1376, 1377.

prevent him from denying that the assessment was duly made. 3. Where the *rights* of creditors of the corporation have supervened,[1] — a subject reserved for future treatment, — for instance, where the subscriber gives his *promissory note* in settlement of his subscription and it passes into the hands of an innocent holder for value before maturity,[2] though this rather concerns an immunity which attaches to negotiable paper. Where the proceeding is by a creditor to enforce the individual liability of the stockholder, this principle of estoppel extends so far as to prevent him from setting up the unconstitutionality of the charter as his defense.[3]

§ 1854. This Principle Limited to Corporations Which may Lawfully Exist. — There can be no *de facto* officer where the office itself does not exist;[4] and it is a limitation of the rule we are considering that it applies only where the corporation is one which may lawfully exist, except in cases where the rights of creditors intervene. Upon this subject the following observations have been made in a judicial opinion: "It must be remembered that such a suit is essentially a suit upon a contract; that this contract is the constating instrument of the corporation — in this case, its articles of association. It logically follows that when this contract is put in evidence in support of the plaintiff's claim, if it is seen, by the terms of the contract itself, that it is an unlawful contract, the court will refuse to enforce it, whatever may be the state of the pleadings or the disposition of the parties. The reason is, that a court of justice will not lend itself to a violation of law — will not put itself in contempt of its sovereign, although both parties to a suit may ask to do so. We might illustrate this rule by supposing a strong case. Keeping a gambling house is a felony in this State. Suppose that a suit were brought by a corporation against one of its shareholders for calls, and that, on the trial of the action, the articles of association offered in evidence should show that the corporation was organized for the purpose of owning and running a gambling

[1] *Post*, § 3683.

[2] Camp *v.* Byrne, 41 Mo. 525.

[3] McCarthy *v.* Lavasche, 89 Ill. 270; *s. c.* 31 Am. Rep. 83. See a learned note on this subject in 19 Am. & Eng. Corp. Cas. 298.

[4] *Ante*, § 505.

house, — we apprehend that no court would allow the suit to proceed further, no matter what might be the state of the pleadings, or the disposition of the parties. If, then, this corporation is a corporation prohibited by the constitution of this State, this suit is a suit brought to enforce an unlawful contract, and the plaintiff must be repelled." [1]

§ 1855. **Constitutionality of the Charter or Governing Statute.** — In strict logic this exception to the rule would allow the shareholder, when sued by the pretended corporation on his contract of subscription, to show that the charter or act under which the incorporation took place was itself prohibited by the organic law, — that is to say, that the act of incorporation was *unconstitutional.*[2] Such a corporation would, in a strict sense, stand on the footing of a prohibited corporation. But, on obvious grounds of public convenience and necessity, this concession to logic has been refused; and it has been held that the rule governs which prohibits the trial of the question of corporation or no corporation in a collateral proceeding, even where the action is brought by the corporation, and where the validity of the act of incorporation is sought to be drawn in question on constitutional grounds.[3] Another court has held that a stockholder in a corporation who has participated in its organization and acted as a director, cannot set up the unconstitutionality of the statute under which the organization was had, as a defense to the payment of his stock subscription.[4] For stronger reasons, the principle of estoppel will prevent the stockholder of a corporation, whose charter is repugnant to the constitution of the State, and hence void, from urging that fact when sued in respect of his individual liability to creditors under the charter.[5]

[1] St. Louis Colonization Asso. *v.* Hennessy, 11 Mo. App. 555, 557.

[2] See *ante*, § 505.

[3] St. Louis *v.* Shields, 62 Mo. 247. The question here was whether the act was not within the prohibition of the constitution of the State against the passage of special laws.

[4] Weinman *v.* Wilkinsburg &c. R. Co., 118 Pa. St. 192.

[5] McCarthy *v.* Lavasche, 89 Ill. 270; *s. c.* 31 Am. Rep. 83; 10 Chi. L. N. 342. In giving the opinion of the court Mr. Justice Walker said: "May shrewd, intelligent persons go to the General Assembly and procure a law that they should know is prohibited by the fundamental law, avail themselves of its benefits, obtain the money of the uninformed and the

§ 1856. Defense that the Charter was Obtained by Fraud. — It cannot be shown as a defense to such an action that the charter of the company was obtained by fraud, and it is proper to exclude evidence tendered for this purpose, provided it appear that the shareholder participated in the business of the company, voted to accept an amendment of its charter, acted as a director, etc.[1] But it has been held that "where a charter has been obtained by means of fictitious subscriptions for part of the stock, and a fraud has been committed on a *bona fide* subscriber, by which he has either sustained or might sustain injury, no action can be maintained against him by the corporation for the amount of his subscription, unless such subscriber has accepted the charter and by his own acts has assisted in putting it in operation."[2] In the same case the doctrine on which we are commenting was said not to apply in cases where the corporation never had any legal existence, but was a *sham*, and where a large portion of the stock was fraudulently and fictitiously created, for the mere purpose of being used as a *decoy* to induce other people to subscribe. Accordingly, where the affidavits, required by the law as a condition precedent to the issuing of the license by the Secretary of State, were shown never to have been filed, and where the $5,000 in cash of the capital stock, as required by the statute, had not been paid in by the subscribers at the time the license was issued, it was held that the corporation could not maintain an action against a subscriber to enforce his stock subscription.[3]

§ 1857. Illustrations. — It follows that it is not necessary for the corporation, in order to maintain such an action, to prove that the corporation is authorized by law and is still in existence.[4] In the case of a *railroad company* it was held no defense that the *articles of*

confiding, and then be heard to say, 'We are not incorporated; our charter and organization are void, and we will hold your money?' Or may those who promoted the enterprise by becoming stockholders, to enable the company to organize and to procure other people's money, be heard to interpose such a defense? * * * Justice, morality, public policy, and precedent all demand that appellant should be estopped from denying the constitutionality of the law."

[1] Smith *v.* Heidecker, 39 Mo. 157.

[2] Occidental Ins. Co. *v.* Ganshorn, 2 Mo. App. 205, 208.

[3] *Ibid.* See also Wells *v.* Jones, 41 Mo. App. 1.

[4] South Georgia R. Co. *v.* Ayres, 56 Ga. 230.

incorporation were defective in not definitely stating the *termini* of the road or the counties through which it passed; since, notwithstanding the defect, the shares of stock to which his subscription entitled him were shares in a corporation *de facto*.[1] And generally, a subscriber to the capital stock of a railroad company, when sued for his subscription, cannot set up in defense any mere irregularity in the organization of the company, provided it is a corporation *de facto*, proceeding without interference of the State authorities in the construction, completion and maintenance of its road.[2] So, it is no defense to an action by a mutual insurance company to collect assessments, to show that it met and chose officers before its charter went into effect, if, subsequently to that time, persons were found, with the consent and under the authority of the designated corporators, and without objection on the part of the commonwealth, actually exercising the corporate powers, and claiming and using the franchise.[3]

§ 1858. Where the Proceeding against the Stockholder is by or on Behalf of the Creditors of the Corporation. — When the stockholders in a body which has acted and held itself out as a corporation are proceeded against by creditors, they are equally estopped by their own conduct from denying that they are a corporation;[4] for it would be palpably wrong to permit a defendant, who is one of the owners of the capital stock of a *de facto* corporation, which operates and sues for his benefit, to set up a failure of its organizers to perform a duty initiatory to its legal existence, when the plaintiff, if sued by the corporation for the defendant's benefit, could not set up the same fact as a defense to the suit.[5] "Their own acts," says Brickell, C. J., "vitalized the corporation, gave it credit, and induced dealings with it; and it is true conservatism and sound policy, promotive

[1] Cayuga Lake R. Co. *v.* Kyle, 64 N. Y. 185.

[2] Monroe *v.* Fort Wayne &c. R. Co., 28 Mich. 272.

[3] Appleton &c. Ins. Co. *v.* Jesser, 5 Allen (Mass.), 446.

[4] Eaton *v.* Aspinwall, 19 N. Y. 121; Mead *v.* Keeler, 24 Barb. (N. Y.) 20; Abbott *v.* Aspinwall, 26 Barb. (N. Y.) 202; Slocum *v.* Providence Steam &c. Co., 10 R. I. 112; Chubb *v.* Upton, 95 U. S. 665; Methodist Episcopal Church *v.* Pickett, 19 N. Y. 482; Upton *v.* Hansbrough, 3 Biss. (U. S.) 417; McCarthy *v.* Lavasche, 89 Ill. 270; *s. c.* 31 Am. Rep. 83; 10 Chi. Leg. N. 342; Buffalo &c. R. Co. *v.* Cory, 6 N. Y. 75; McHose *v.* Wheeler, 45 Pa. St. 32; Rice *v.* Rock Island &c. R. Co., 21 Ill. 93; Tarbell *v.* Page, 24 Ill. 47, 48; Wheelock *v.* Kost, 77 Ill. 296.

[5] Eaton *v.* Aspinwall, 19 N. Y. 119, 122.

of right and equity, to seal their lips against contradiction and denial of that which they must be taken to have affirmed to the injury of strangers who have trusted the affirmation." [1]

§ **1859. Illustrations.** — Defenses of this kind have been held unavailing in the following cases: The statute required the filing of a *certificate of incorporation*, stating, among other things, "the number of trustees, and their names, who should manage the concerns of the company for the first year," after which the persons therein named should become a body corporate, etc., and the certificate contained no such statement, but the company went into operation, and continued in operation for about twenty years, until dissolved by the judgment of a court, and a shareholder was afterwards sued on one of its contracts. The statute was held to be directory only, and the defendant was estopped from urging this defense.[2] The making of such a certificate has been held not a condition precedent to the existence of the corporation, and a failure to make it cannot be set up as a defense by the corporation against a creditor; [3] nor by a stockholder against a creditor; [4] nor could the corporation set up, as a defense to an action against it, its falsehood, if made.[5] So, where the statute provided that, where a certificate of incorporation should be filed, and *ten per cent. of the capital* should be paid in, the persons named should become a body corporate, etc., a shareholder, when sued upon a corporate indebtedness, could not urge that ten per cent. of the capital named had not been paid in. Such a company, though not a valid corporation in point of law, might carry on its enterprises, have its day in court, and divide its revenue among the holders of the shares of its capital, until the State should interpose and ask that it should be dissolved. The only real necessity for complying with the statute in relation to the payment of the ten per cent. was to prevent proceedings in behalf of the people from putting an end to its corporate functions. The fact that such a company kept a public office, transacted business in its corporate name, kept the usual corporate books, upon which the defendant appeared as a shareholder before the contracting of the debt sued on,—raised the inference that the

[1] Central Ag. Asso. *v.* Alabama &c. Co., 70 Ala. 120, 133; *s. c.* 9 Am. Corp. Cas. 8, 13. And see McCarthy *v.* Lavasche, 89 Ill. 270; *s. c.* 31 Am Rep. 83.

[2] Mead *v.* Keeler, 24 Barb. (N. Y.) 20.

[3] Merrick *v.* Reynolds Engine Co., 101 Mass. 381.

[4] Tarbell *v.* Page, 24 Ill. 46.

[5] Dooley *v.* Cheshire Glass Co., 15 Gray (Mass.), 494. See Boston Acid Co. *v.* Moring, 15 Gray (Mass.), 211; Newcomb *v.* Reed, 12 Allen (Mass.), 362; Narragansett Bank *v.* Atlantic Silk Co., 3 Metc. (Mass.) 385.

credit was given on the faith, not only of the liability of the corporation as such, but ultimately of the several shareholders of its capital, and the defendant was hence estopped from making such a defense.[1]

§ **1860. Illustrations Continued.**—Neither is it competent for a stockholder to avoid payment of an execution levied upon his property, under the provisions of a statute of Rhode Island,[2] by showing that the *fee* or *tax* required by another statute to be paid to the treasurer of the State, *before its charter should take effect*, had never been paid. Although, by reason of the non-payment of this fee, the act of incorporation never went into effect,[3] yet the shareholder was estopped to show this fact. Durfee, J., in giving the judgment of the court, said: "The plaintiff, in order to have the relief which he seeks, ought to satisfy us, not only that his company is not a corporation, but also that he is entitled to show the fact against its creditors. We assume, as we think the bills warrant us in assuming, that the plaintiff is a stockholder in the American Steam and Gas Pipe Company, though he has done nothing as such except hold his stock. The question, then, is whether a stockholder, who does nothing but hold his stock, is estopped, when pursued by a creditor of the supposed corporation, from denying its existence. We think he is so estopped. By becoming and continuing a stockholder, he holds himself out as a corporator, and so contributes to the belief that the company with which he is associated is a corporation. To permit a person who has so held himself out to say that he is not a corporator, when legally pursued as such, would be to permit him to take advantage of his own wrong. He is like a person who, having held himself out, or suffered himself to be held out, as a copartner, may be charged with the copartnership debts. Or he is like a person who, without authority as executor or administrator, intermeddles with the property of a decedent, and so becomes chargeable as an executor in his own wrong. The plaintiff having assumed the character of a corporator, where he is sought to be charged as such, ought not to be heard to say that the character was falsely or unlawfully assumed. The fact that he was not active in the business of the company cannot avail him; for it is the assumption to hold the stock, as if he were a corporator, which makes the

[1] Eaton *v.* Aspinwall, 19 N. Y. 119; *s. p.*, Abbott *v.* Aspinwall, 26 Barb. (N. Y.) 202; McHose *v.* Wheeler, 45 Pa. St. 32. See *ante*, § 1216, *et seq.*

[2] Rev. Stat. R. I. ch. 128, §§ 11, 12. This statute requires the filing with the town clerk of a certain annual certificate or statement, in default of which the members are jointly and severally liable for all debts of the corporation.

[3] Union Horseshoe Works *v.* Lewis, 1 Abb. (U. S.) 518.

mischief. It might easily happen that the stockholder whose name contributed most to the credit of the supposed corporation was least active in its business, and it would be plainly unjust to exempt him from liability to the creditors merely because of his inactivity."[1] The same ruling has been made in Pennsylvania.[2]

§ 1861. **Illustrations Continued.**—Upon like grounds, where an insurance company attempted to *increase its capital stock;* filed papers for that purpose in the office of the auditor of State; received subscriptions for and sold its capital stock under such assumed increase; received part payment thereon, and incurred large liabilities upon policies of insurance bearing upon their face evidence of such increase;—this was held sufficient to constitute the company a corporation *de facto*, so that neither it nor its stockholders could object that it was not a corporation *de jure*, or that it had no power to issue such an increase of stock.[3] For stronger reasons, where a director visited the plaintiff at his place of business, and represented that the corporation had been legally organized, and that he was a director in it, and the plaintiff, on the strength of this representation, sold goods to the corporation and accepted the notes in settlement, such director was estopped from setting up its defense, in a suit for the corporate debt, that the corporation was never legally organized, and that, therefore, he could not be personally held liable for its debts.[4]

§ 1862. **Estoppel to Set up Non-Existence of Corporation at Time of Subscription.**—We have already seen that subscriptions to the capital stock of a corporation, *made before its organization*, inure to its benefit when it is once formed, and become in judgment of law, contracts between the subscriber and the corporation,—though the courts have rested this conclusion on various theories and refinements.[5] In their struggles with this question the courts have sometimes rested their con-

[1] Slocum *v.* Providence Steam and Gas Pipe Co., 10 R. I. 112, 114.

[2] Patterson *v.* Wyamissing Co., 40 Pa. St. 117.

[3] Upton *v.* Hansbrough, 3 Biss. (U. S.) 417. "To the public," said Hopkins, J., in this case, "this company had all the external *indicia* of being a corporation, and legally entitled to exercise the rights and privileges it assumed to exercise. A party voluntarily taking stock in such a company is not in a position, when sued for the balance due for such stock, for the benefit of the creditors of such company, to deny the authority of the company to issue such stock, and to transact business lawfully."

[4] Corey *v.* Morrill, 61 Vt. 598; *s. c.* 17 Atl. Rep. 840.

[5] *Ante*, § 1170, *et seq.*

clusion on the ground that, in such a case, as in others, the shareholder, when sued by the corporation, is *estopped* from denying its lawful existence;[1] and this principle of estoppel comes into play with stronger force where the action against a stockholder is by or on behalf of the creditors of the corporation.[2]

§ **1863. Charter Forfeited: Corporation Dissolved.**— On a similar principle, where the proceeding is by or on behalf of creditors, it is totally immaterial that, as soon as the indebtedness was created, the corporation had been dissolved by the State on the ground that it never legally existed.[3] For, although by a rule of the common law a forfeiture of a corporate charter may extinguish all debts due by the corporation, yet the collateral undertaking of the stockholders, under a section of its charter which makes them individually liable for its debts, will remain unimpaired.[4]

§ **1864. Rule Works in Favor of Stockholders.** — As already seen,[5] if a corporation has no existence, even *de facto*, its associates are liable to its creditors as *partners;* but the rule under consideration works to protect the stockholders in a *de facto* corporation from the unlimited liability of partners, as well as to render them liable to the extent of their obligations as stockholders. Accordingly, it has been ruled that, in the absence of a statutory provision making shareholders liable in case of failure to comply with the requirements of a charter, persons who have contracted with a *de facto* corporation as a corporation, cannot deny its existence, in order to charge its stockholders individually as partners.[6] Another court has stated the rule which protects them even more broadly, by holding that persons dealing with a corporation which is not legally organized cannot, for this reason, proceed against the stockholders who for several

[1] Dorris *v.* French, 6 Thomp. & C. (N. Y.) 581; *s. c.* 4 Hun (N. Y.), 292.

[2] Bell's Appeal, 115 Pa. St. 88; *s. c.* 2 Am. St. Rep. 532; 8 Atl. Rep. 177; 6 Cent. Rep. 159, 160; 11 East. Rep. 608, 665. But see *post*, § 1872.

[3] Rowland *v.* Meader Furniture Co., 38 Oh. St. 270; Gaff *v.* Flesher, 33 Oh. St. 107 and 453.

[4] Robinson *v.* Lane, 19 Ga. 337; *Post*, §

[5] *Ante*, §§ 218, 417.

[6] Stout *v.* Zulick, 48 N. J. L. 599.

years acted as a corporation in good faith, supposing themselves to be incorporated, the State not having moved in the matter.[1]

§ **1865. Effect of Payment of Installments or Assessments.**— The Court of Appeals of Maryland addresses itself to this question in a somewhat early case, reasoning that, as a general rule, strict compliance with its charter, as to organization, must be shown by a corporation seeking to enforce payment of subscriptions to its stock; but in some cases compliance will be presumed, and in others it may be waived. But the court held that the *payment of an installment* on a subscription to its stock, is a sufficient recognition of the legal existence and organization of the corporation by the subscriber so paying, to enable it to recover the remaining installments from him.[2] On the other hand, the Supreme Court of Alabama hold that, in an action to enforce a subscription to corporate stock, a declaration that the defendant paid all of his subscription except that sued on, which is alleged to have been duly and regularly called in and demand therefor made, payment of which was refused by the defendant, does not allege sufficient facts to create an estoppel to dispute the corporate existence.[3]

§ **1866. Effect of Taking Part in Organization, Attending Meetings, etc.**— All the courts agree that the adventurers in corporate enterprises cannot deny the existence of the corporation after they have effected its organization, and had the benefit of its incorporation.[4] Accordingly, it has been held that "if a subscriber, knowing that the requisite subscriptions have not been made to fill up the capital, attends meetings of the corporation, co-operates in the votes for expending money and for making contracts, and in other acts which could only be properly done upon the assumption that the subscribers intended to proceed with the stock partially taken up, such subscriber might be

[1] Gartside Coal Co. *v.* Maxwell, 22 Fed. Rep. 197.

[2] Maltby *v.* Northwestern &c. R. Co., 16 Md. 422.

[3] Schloss *v.* Montgomery Trade Co., 87 Ala. 411; *s. c.* 13 Am. St. Rep. 51; 6 South Rep. 360.

[4] *Ante*, § 528, *et seq.*; Rockville &c. Turnp. Road *v.* Van Ness, 2 Cranch C. C. (U. S.) 449. Compare Danbury &c. R. Co. *v.* Wilson, 22 Conn. 435.

estopped from setting up this defense.[1] So, in a suit by a corporation against one of its stockholders for calls, a stockholder participating in the organization of the corporation, who at the first election had been chosen a director, and had acted as such, was estopped to deny the validity of the corporate organization on the ground that notice of such election had not been given and that some of the subscribers did not attend.[2]

§ 1867. The Same where the Rights of Creditors are Involved. — The principle applies with even stronger force where the rights of creditors are involved;[3] so that a subscriber to the stock of a corporation who takes part in its business, attends its meetings, acts as a director,[4] and the like,[5] thereby estops himself, when proceeded against by or on behalf of the company's creditors, from disputing the lawful existence of the corporation. The principle acquires even greater force where the facts which raise the estoppel have existed for a great *lapse of time*. Thus, a defendant, whom it was attempted to hold liable for a debt of a corporation which had been judicially recognized as duly organized under the New York act of 1811, and had acted as such over twenty years, and in which the defendant held stock until its dissolution, was not allowed to deny the legal incorporation of the company, in the action against him.[6] In another case a subscriber to the stock of a corporation was sued on his subscription, after its *consolidation* with another corporation. It appeared that he had joined and acquiesced in the proceedings for consolidation made by his own company; that the stockholders of the other company had raised no objection, and that the consolidation had taken place years before. It was held that he could not set up technical objections to the proceedings taken *by the other corporation* to effect the consolidation.[7]

§ 1868. Opposing Doctrine that the Existence of the Corporation Must be Proved. — Some authority is found in the

[1] Cabot &c. Bridge *v.* Chapin, 6 Cush. (Mass.) 50.

[2] Schenectady &c. R. Co. *v.* Thatcher, 11 N. Y. 102.

[3] *Ante*, §§ 528, 1376, 1377.

[4] Smith *v.* Heidenecker, 39 Mo. 157.

[5] Eaton *v.* Aspinwall, 6 Duer (N. Y.), 176; *s. c.* aff'd, 19 N. Y. 119.

[6] Mead *v.* Keeler, 24 Barb. (N. Y.) 20.

[7] Wells *v.* Rodgers, 60 Mich. 525; *ante*, § 354.

decisions of authoritative courts, to the effect that in actions of this nature, whether by the corporation to recover an assessment, or by or on behalf of creditors, the stockholder will not be estopped to deny the existence of the corporation, but that its existence must be proved by the plaintiff.[1] Thus, it has been held in Indiana that until the statutory requirements to organize a corporation have been complied with, a subscriber to the articles of association is not estopped to deny the existence of the corporation.[2] So it has been held in Maine that in an action to charge a shareholder with liability for the debts of a corporation the existence and organization of the company must be proved. The judgment, obtained apparently against the company, may not be conclusive of such existence and organization, in an action to which he is a stranger; but the highest species of proof of these facts is said to be as necessary and proper in such an action as for other purposes where the existence and organization are questioned.[3] The Supreme Judicial Court of Massachusetts have reasoned that, one of the essential requirements of the statute touching the organization of corporations being that the persons who are to be created a corporation should associate themselves together by articles of agreement in writing, where this cannot be shown, notwithstanding it appears that some organization took place with a view to establish a corporation, persons alleged to be stockholders cannot be held to their statutory liability as such for debts of this body, for the obvious lack of any authentic evidence showing how the body was constituted or the extent of their interests in it.[4]

§ 1869. A Judicial Review of the Decisions on this Question. — In a case in the Supreme Court of Rhode Island,[5] the subject was again carefully reconsidered, and the opposing decisions were critically examined. I shall best exhibit these opposing cases by quoting the language of the very learned and experienced judge who delivered the opinion in the case alluded to. Durfee, J., said: "The

[1] Hudson *v.* Carman, 41 Me. 84, 88; Unity Ins. Co. *v.* Cram, 43 N. H. 636; Utley *v.* Union Tool Co., 11 Gray (Mass.), 139.

[2] Indianapolis &c. Mining Co. *v.* Herkimer, 46 Ind. 142.

[3] Hudson *v.* Carman, 41 Me. 84, 88.

[4] Utley *v.* Union Tool Co., 11 Gray (Mass.), 139.

[5] Slocum *v.* Warren, 10 R. I. 116.

facts on which the question to be decided arises are these: In 1863 a public statute was passed which provided that no act of incorporation granted after the passage thereof, with certain exceptions, should take effect until the persons therein incorporated should have paid to the general treasurer the sum of one hundred dollars, if the capital limited by the act was the sum, or any less sum than one hundred thousand dollars. In 1867 the charter for the Providence Steam and Gas-Pipe Company was granted, the capital named being seventy-five thousand dollars. The grantees of the charter proceeded to organize under it, and to transact business as a corporation, without first paying the one hundred dollars as required. The plaintiff became a stockholder, and the defendant, Elizabeth Warren, made the loan as above stated, relying for repayment not only upon the credit of the company, but also upon the personal liability of the stockholders, and of the plaintiff, especially, as one of them. The company having failed to repay the loan, the said Elizabeth Warren seeks to charge the plaintiff personally as a corporator; and the plaintiff replies that he cannot be so charged, because, by reason of the omission to pay the tax, the charter never went into effect, and consequently the supposed corporation never had any legal existence. We decided in the former case that having, by becoming a stockholder, helped to hold the company out as a corporation, he could not be permitted to say, when pursued by a creditor of the company, that he and his associates or predecessors had omitted to do an act which they ought to have done before organizing as a corporation, and that in consequence of this delinquency the company was not (what it purported to be) a legally established corporation. The plaintiff maintains that this decision was erroneous, and in support of his view relies especially upon the cases of Hudson *v.* Carman,[1] Unity Insurance Company *v.* Cram,[2] Utley *v.* Union Tool Company,[3] and Gardner *v.* Post.[4] We propose to consider these, and some of the other cases bearing upon the question, somewhat in detail. Hudson *v.* Carman was an action to charge a stockholder, under the statute of Maine, upon a debt due from the corporation, judgment thereon having been rendered against the corporation. The plaintiff offered the books of the corporation to prove its acceptance of the charter and its organization. The judge ruled that the existence and organization of the corporation should first be proved *aliunde* before the books could be introduced. To this ruling the plaintiff excepted, and his exception was sustained by the Supreme Court. It does not appear but that the corporation was duly created and organized, the question being simply by what evi-

[1] 41 Me. 84.

[2] 43 N. H. 636.

[3] 11 Gray (Mass.), 139.

[4] 43 Pa. St. 19.

dence these facts should be proved. In deciding this, the court remarked — though the remark was not called for by the question before them — that in such an action it was necessary, if required, that the existence and organization of the corporation should be established, and that judgment against the company was not conclusive of such existence and organization. The Unity Insurance Company *v.* Cram was an action upon a promissory note given by the defendant for insurance by the plaintiff company, which claimed to have formed as a corporation for mutual insurance under the New Hampshire statute. It appeared that the company, in its formation, had not observed the requirements of the statute, and the court held that it was not a corporation authorized to issue a policy of insurance, and gave judgment for the defendant. Utley *v.* Union Tool Company was a proceeding, under the Massachusetts statute of 1851, to charge certain persons as stockholders of a manufacturing corporation, judgment having gone against the alleged corporation by default. In the trial at *nisi prius*, the court ruled that it was not necessary to prove the existence of the corporation, that having been admitted by the default. An exception taken to this ruling was sustained by the Supreme Judicial Court, which declared that, in such a proceeding, the burden of proof was on the plaintiff to show the legal existence of the corporation. Gardner *v.* Post was an action against the directors, officers, and agents of a bank, described in the declaration as a corporation lawfully established, for unlawfully issuing notes of the denomination of $5, $10, $20, and $50, of which the plaintiff had received and held $30,000. The court held that a charter or letters-patent from the government were necessary to create the bank a body corporate, and that these not having been proved by the plaintiff, or *in any manner attempted to be supplied*, he failed in supporting his declaration. The question of estoppel does not appear to have been raised in either one of these cases; and though we are not disposed to think that they are, on that account, of no weight as authority, we nevertheless do think that they are entitled to very much less consideration than they would have been if the question had been raised. The plaintiff also cites the cases of Harriman *v.* Southern,[1] Jones *v.* Cincinnati Type Foundry Company,[2] and Heaston *v.* Cincinnati Railroad Company.[3] The view expressed in these cases is that if a company organizes as a corporation where there is no law, or only an unconstitutional law, authorizing such organization, the doctrine of estoppel does not apply; but that where there is a law under which the corporation might be rightfully organized, there the doctrine of estoppel is applicable. It seems to us that these cases tell rather against than in favor of the

[1] 16 Ind. 190. [2] *Ibid.* 85. [3] *Ibid.* 275; *s. c.* 75 Am. Dec. 430.

plaintiff, for here there was a charter duly granted, and though it was not to go into effect until a certain tax was paid, there was nothing to prevent the grantees of the charter from paying the tax, and then organizing with perfect regularity, both in fact and in law.[1] The plaintiff also cites cases in which it has been held that a corporation, duly established as such, is not estopped from denying its liability where there is a want of power to contract the liability, the reason being, he says, that otherwise the powers of the corporation might be indefinitely enlarged; and he argues that, in the case at bar, the doctrine of estoppel is still less applicable, inasmuch as the company was acting not merely in excess of its corporate powers, but without any corporate power whatever. But in the case at bar the defect of power exists not by reason of any insufficiency of the grant, but by reason solely of a delinquency on the part of the grantees of the power; and the estoppel, if applied, would be applied not to prevent an appeal to the charter, to show a want of authority, but to prevent the introduction of evidence by the company or its members, to prove their own delinquency. We do not think that in such a case there should be any hesitation to apply the doctrine of estoppel, from fear that it would lead to an indefinite enlargement of the powers of the corporation."[2]

§ 1870. Continued. — In the same case[3] the opinion of the court continues: "On the other hand, there are cases in which the doctrine of estoppel has been applied both in favor of and against corporations, which, for the light they throw on the question under review, are entitled to consideration. There are numerous cases in which it has been held that where a person has entered into a contract with a company as a corporation, and has received the benefit of his contract, he is estopped to deny the legality of its organization.[4] In Zabriskie *v.* Cleveland, etc., Railroad Company[5] the directors of a railroad company had entered into a guaranty which they could not legally enter into without the assent of two-thirds of the corporation, given at a called meeting, or until after the provisions of a certain act had been accepted and the certificate of its acceptance filed with the Secretary of State. There was no proof of such certificate, but, the guaranty having been ratified by the corporation, without dissent, the court refused, at the instance of the

[1] Citing Brownlee *v.* Ohio &c. R. Co., 18 Ind. 68.

[2] Slocum *v.* Warren, 10 R. I. 116, 118. Opinion by Durfee, J., citing Bargate *v.* Shortridge, 5 H. L. Cas. 297, 318; Zabriskie *v.* Cleveland &c. R. Co., 23 How. (U. S.) 381.

[3] Slocum *v.* Warren, 10 R. I. 116, 121.

[4] Citing Abb. Dig. Corp. 333, § 39, *et seq.*; Herman on Estop., § 571.

[5] 23 How. (U. S.) 381.

corporation, to enjoin its execution. The court said: 'The acceptance of these acts may be inferred from the conduct of the corporators themselves. The corporation have executed the powers and claimed the privilege conferred by them, and they cannot exonerate themselves from the responsibility by asserting that they have not filed the evidence required by the statute to evince their decision.' [1] In the United States Express Company *v.* Bedbury [2] the company was proceeded against as a corporation, by process of garnishment, and appeared to the suit by the name of 'The United States Express Company.' One question raised related to the sufficiency of the service, which was valid only in case the company was a corporation. The court decided that the name in which they had appeared imported a corporation, and remarked: 'It seems to comport with reason that when an association of persons assume a name which implies a corporate body, and exercise corporate powers, they should not be heard to deny that they are a corporation. When they do act and contract, they are estopped from denying their corporate liability.' In Rockville, etc., Turnpike Company *v.* Van Ness [3] the charter of the company required that 1,500 shares of the stock should be subscribed, as a prerequisite of the organization. The defendant, a subscriber, being sued on his subscription, offered to show that the 1,500 shares had not been subscribed, some of the subscriptions being without authority; but it appearing that the company had been organized, the defendant himself taking part and being elected a manager, the evidence was rejected. The court said: 'It is not competent for any stockholder to make the objection to the existence of the corporation, inasmuch as they have elected the president and managers, and have had all the benefits of a corporation. They cannot now set up as a defense their own want of power.' [4] In Galveston Railroad Company *v.* Cowdrey [5] it was decided that *bona fide* holders of railroad bonds, executed in due form and by the proper officers, could not be prejudiced by the fact that the mortgage given to secure the same was executed out of the State, or by virtue of a resolution adopted by the directors at a meeting held out of the State. Justice Bradley, in delivering the opinion, said: 'We see no reason why it should not be estopped by the action of its directors in another territory, when that action is the basis of negotiations by which third parties have *bona fide* parted with their money, and the company has received the benefits of the

[1] Citing Owen *v.* Purdy, 12 Ohio St. 73.

[2] 34 Ill. 459.

[3] 2 Cranch C. Ct. (U. S.) 449.

[4] Citing Rice *v.* Rock Island &c. R. Co., 21 Ill. 93; West Winsted Savings Bank *v.* Ford, 27 Conn. 282; *s. c.* 71 Am. Dec. 66.

[5] 11 Wall. (U. S.) 459.

transaction.' The case of Camp *v.* Byrne[1] is a still stronger case. In that case the charter was granted by the State of Tennessee, and the only organization under it was effected in Missouri. The court held that the organization of the company did not constitute it a corporation; but also held, at the same time, that the defendant, a subscriber to the stock thereof, who had given to the company, as a corporation, his note for the amount of his subscription, when sued by a *bona fide* indorsee of the note for value before maturity, was estopped from denying the legal existence of the corporation. In Massachusetts it has been held that a company, sued as a corporation formed under a general statute, is estopped to set up, for the purpose of defeating the action, the falseness of the certificate filed by it as a compliance with the requirements of the statute, or to avail itself of its omission to publish the certificate of its organization required by the statute.[2] In New York it is declared to be the law that where there is a colorable, but defective, organization under a general law, the company, by acts of user, become a corporation *de facto*, and no advantage can be taken of the defect, collaterally, by any person.''[3]

§ 1871. Continued: The Proper Distinction Stated.— In the same case[4] the learned judge proceeds to define what seems to be the proper limit of the rule, in the following language: "It is true that these cases are not precisely like the case at bar, but they are cases which illustrate the application of the law of estoppel in respect to corporations, or companies acting as corporations, or which illustrate to what extent the corporate existence of a company acting as a corporation can be collaterally questioned. And we think it is safe to say, upon the authority of these cases, that at least where there is an act or charter in existence under which a company, by taking the proper steps, can become a corporation, if a company does *de facto* organize and hold itself out as a corporation, contracting obligations as such, it cannot, when sued upon such obligations by persons who have dealt with it as such in good faith, be permitted to avoid a corporate liability thereon by setting up that it has not

[1] 41 Mo. 525.

[2] Citing Dooley *v.* Cheshire Glass Co., 15 Gray (Mass.), 494; Callender *v.* Painesville &c. R. Co., 11 Ohio St. 516.

[3] Slocum *v.* Warren, 10 R. I. 116, 121; opinion by Durfee, J., citing Buffalo &c. R. Co. *v.* Cary, 26 N. Y. 75; Eaton *v.* Aspinwall, 19 N. Y. 119; Holmes *v.* Gilliland, 41 Barb. (N. Y.) 568; Abbott *v.* Aspinwall, 26 Barb. (N. Y.) 202; Mead *v.* Keeler, 24 Barb. (N. Y.) 20; Leonardsville Bank *v.* Willard, 25 N. Y. 574.

[4] Slocum *v.* Warren, 10 R. I. 116, 121.

taken all the steps prescribed as conditions precedent to its legal existence as a corporation. If this be so in regard to the company as a whole, we do not see why it is not equally so in regard to each member of the company individually, in so far as membership imports an individual liability. In this case, it is said, there was no act, or charter; but in our opinion there was a charter duly granted by the legislature, subject only to a condition that it should not take effect until a certain act should be performed; but inasmuch as this act could have been performed, as it ought to have been performed, by the grantees of the charter before their organization as a corporation, the case does not, in our view, substantially differ from cases which are clearly within the rule above stated. Indeed, it is frequently the case that a charter is granted subject to an implied condition that the grant shall not take effect until it has been duly accepted; and yet, as we have seen, the doctrine of estoppel may be applied to prevent the want of such an acceptance from operating to defeat a just claim.[1] In this case the company had only to pay into the treasury of the State one hundred dollars, and all would have been right. When it organized as a corporation, and from year to year continued doing business as such, it as much as said, and each one of the stockholders as much as said, that that sum had been paid and now neither the company nor any one of the stockholders ought to be heard to assert the contrary, in order to escape any liability to which he or it would have been subject if the payment had been duly made. This decision is, doubtless, a hard decision for the plaintiff, and we very much regret that his situation is such that he is so severely affected by it. But hard as the decision is for the plaintiff, it only subjects him to the liability to which he would have been subjected if the tax due the State had been paid, as it ought to have been paid, and, therefore, only to the liability which, as an honest man, he must be presumed to have intended to incur when he connected himself with the company."

§ **1872. Cases where this Defense was Successful.** — Cases have been found where this defense was successfully set up. Where it appeared that the meeting at which subscriptions of stock were made, was not a meeting of the corporation, but only of individuals, and that the capital stock was increased, not by a vote of the corporation, as required by its charter, but by a vote of these individuals, — it was held that the corporation was not legally organized, and that an action to recover the amount of a subscription could not be main-

[1] Citing Camp *v.* Byrne, 41 Mo. 525; Tobacco Pipe-Makers' Co. *v.* Woodroffe, 8 Dow. & Ry. 530; Abb. Dig. Corp. 331, § 23.

tained.[1] - - - - In an action to recover the amount subscribed by the defendant in an agreement to unite with others in the formation of a joint-stock or incorporated company, for certain specified purposes, and to pay the amount of his subscription to the treasurer of such company, — it was held: 1. That the legal and effectual formation of a corporation or joint-stock company was a condition precedent to the defendant's obligation; and that he had, therefore, a right to contest the validity of the alleged organization of such a company. 2. That, even if the alleged company was legally organized, the defendant was not liable, as its business included branches in which he had never contracted to engage.[2] This case was not very well reasoned. Rapallo, J., said: "It may be that a corporation *de facto* was established, and that if the defendant had contracted with it after its formation, he would have precluded himself from setting up the invalidity of its organization as a defense to an action upon his contract. This, however, would rest upon the ground that by contracting with it he had recognized its existence as a corporation. No such ground could be assumed where the contract was made *before the formation of the corporation*,[3] and was conditioned upon its formation. A legal and effectual formation of a corporation or joint-stock company for the purpose specified in the contract was a condition precedent to his obligation to put in his capital. He would not be bound under such a contract to invest his capital in the stock of a corporation not legally formed, or which had not obtained the franchise of carrying on the business contemplated by the contract, and in which he had agreed to become interested."[4]

§ **1873. View that Question not Triable in Equity.** — In a case in a court of equity the view has been taken that an allegation that a corporation was not properly organized, and therefore, had no authority to collect a subscription made to its capital stock, is a question that can only be tried in a court of law.[5] But while a proceeding to forfeit the charter is necessarily a proceeding at law, yet if such a question can, under any circumstances at all, be tried in a collateral proceeding against a stockholder, the trial can only be a trial for the purposes of *that* proceeding, and it is not perceived why such a trial cannot be as well had in a court of equity as in a court at law, if the court *otherwise* has jurisdiction.

[1] Katama Land Co. *v.* Holley, 129 Mass. 540.

[2] Dorris *v.* Sweeney, 60 N. Y. 463.

[3] See to the contrary, *ante*, § 1862.

[4] *Ibid.* 467.

[5] Thompson *v.* Guion, 5 Jones Eq. (N. C.) 113.

Article II. Conduct Showing Membership — Estoppels.

§ **1877. General Doctrine.**— A great many cases are found, mostly in this country, where persons, by suffering themselves to be held out to the public as shareholders, or by acting as such, have been held estopped to deny that relation. The rule has, no doubt, arisen from the analogy of the corresponding rule relating to partners, or members of joint-stock companies

In England, before the recent Companies Acts, such companies were regarded simply as enlarged partnership firms; the English judges insensibly applied to them this rule of the law of partnerships, and from this it was easily borrowed by the American judges and applied to our chartered corporations. It has been so applied in this country, both where the contest was between a creditor of a corporation, and a person alleged to be a shareholder, and also between the company itself and persons sought to be charged by it as shareholders, in actions for calls. It is obvious that if, in any case, in a contest between the corporation itself and one sought to be charged as a shareholder, he will be held estopped by his conduct to deny that relation, such estoppel will, for stronger reasons, arise against him where the contest is between him and creditors of the company, who may have given credit on the faith of his responsibility as a member. It is perhaps noteworthy that in the cases which have arisen under the recent English Companies Acts, little trace of this doctrine is found. Indeed, it has almost entirely passed out of view in recent cases, and those courts seem to have settled down upon the idea that a person is or is not a shareholder accordingly as he has or has not contracted to be so; that the rights of creditors can only be enforced against him in the right of the company; and that, unless he has made a contract for himself such as charges him with the obligations of a shareholder, the courts will not make one for him.[1] The old English and the present American decisions seem to rest upon a much higher plane of equity. The modern notion seems almost wholly to ignore the rights of creditors, and to afford the amplest facilities for fraud. The numerous English cases where the question of estoppel has arisen with reference to joint-stock partnerships are thought to fall somewhat outside the scope of this discussion, and have not, therefore, been collected in this work.[2]

§ **1878. The American Doctrine Stated.** — The American courts hold that if a person purchases shares, and suffers his

[1] *Ante*, § 1592.

[2] See, however, Dickinson *v.* Valpy, 10 Barn. & Cress. 128; Harvey *v.* Kay, 9 Barn & Cress. 356; Ellis *v.* Schmoeck, 5 Bing. 521; Doubleday *v.* Muskett, 7 Bing. 110; Perring *v.* Hone, 4 Bing. 28. See further Duffield *v.* Barnum Wire &c. Works, 64 Mich. 293; *s. c.* 31 N. W. Rep. 310.

name to appear upon the books of the association, he will not be heard to impeach his own title. He will not be allowed to accept the benefits without shouldering the burdens. This principle has been well set forth in a case arising under the New York banking law: "No doubt a person may show, in exoneration of himself, that his name has been placed on the books without his consent. But if a party makes an actual purchase of shares, whether from the bank or an individual holder, and voluntarily allows himself, in this manner, to be represented to the world as a stockholder, he must take the responsibilities of that situation. He comes within the terms and policy of the act. His title may be imperfect. Equities may exist between him and other parties; the shares may be in dispute; they may be claimed by some one else, in hostility to his own right. The statute has no regard to such questions. The person who has caused or allowed his title to be registered on the books cannot deny the truth of that representation, and disavow the ownership when it ceases to be a benefit and comes to be a burden."[1] Thus, if a person named in the certificate and charter as a member, afterwards acts as such, or, on discovering the use of his name as a member, does not personally disavow it, he cannot evade liability as a member by showing that he was not one in fact, and never paid in any stock. The disavowal must be immediate, or he will, as between himself and creditors, be deemed to have ratified the relation. This rule was applied where the attorney of a judgment creditor of a corporation had accepted stock in satisfaction of the judgment, and the principal had not disavowed the act.[2]

§ **1879. Subscription Implied from Acting as a Member.** — The charter and the previous certificate required by the statute being generally public acts and publicly recorded, if any person named therein as a member afterwards *acts as such*, or does not disavow the relation as soon as he discovers the use of his name, he cannot, as already seen,[3] evade his liability as a member merely by showing that he was not in fact a subscriber, and never paid in any money on account of stock. He must imme-

[1] Matter of Reciprocity Bank, 22 N. Y. 17, per Comstock, C. J.

[2] McHose *v.* Wheeler, 45 Pa. St. 32.

[3] *Ante*, § 1877, *et seq.*

diately and publicly disavow the act, or he will be taken to have ratified it so far as relates to creditors.[1] The liability of such persons has been placed on the principle of *estoppel*.[2] It rests on the principle, already considered,[3] that one who suffers his name to be held out to the public as a member in respect of a given number of shares, whereby others are induced to subscribe or to give credit to the corporation, ought not to be heard to deny that he is such when to continue in the relation has ceased to be profitable to him. The rule and the reason for it have thus been stated: "Where a shareholder in a corporation is called upon to respond to a liability as such, and where a party has contracted with a corporation, and is sued upon the contract, neither is permitted to deny the existence or the legal validity of such corporation. To hold otherwise would be contrary to the plainest principles of reason and of good faith, and involve a mockery of justice. Parties must take the consequences of the position they assume. They are estopped to deny the reality of the state of things which they have made appear to exist, and upon which others have been led to rely. Sound ethics require that the apparent in its effects and consequences should be as if it were real; and the law properly so regards it."[4] So, in a case in Massachusetts, it is said: "No man can be compelled by the legislature to become a member of a corporation without his consent; yet if he do consent, and even not expressly, but by implication, he cannot afterwards deny his liability to the lawful exactions of the

[1] McHose *v.* Wheeler, 45 Pa. St. 41. New Hampshire &c. R. Co. *v.* Johnson, 30 N. H. 390; *s. c.* 64 Am. Dec. 300; Greenville &c. R. Co. *v.* Coleman, 5 Rich. (S. C.) 118; Penobscot R. Co. *v.* Dummer, 40 Me. 172; *s. c.* 63 Am. Dec. 654; Chaffin *v.* Cummings, 37 Me. 76; Chase *v.* Merrimack Bank, 19 Pick. (Mass.) 564; *s. c.* 31 Am. Dec. 163; Haynes *v.* Brown, 36 N. H. 545; Haywood &c. Plank Road Co. *v.* Bryan, 6 Jones (N. C.), 82; Kansas City Hotel Co. *v.* Harris, 51 Mo. 464. That it is a question for a jury, see Phila &c. R. Co. *v.* Cowell, 28 Pa. St. 329; *s. c.* 70 Am. Dec. 128; Miss. &c. R. Co. *v.* Harris, 36 Miss. 17. Compare McCully *v.* Pittsburgh &c. R. Co., 32 Pa. St. 25. That subsequent declarations to strangers do not create such an estoppel, see Rutland &c. R. Co. *v.* Lincoln, 29 Vt. 206.

[2] Hays *v.* Pittsburgh &c. R. Co., 38 Pa. St. 81.

[3] *Ante*, §§ 1376, 1377.

[4] Casey *v.* Calli, 94 U. S. 673, 680, opinion by Mr. Justice Swayne; quoted and followed in Re Central Bank of Canada, 25 Can. L. J. 238, 240.

corporation, on the ground that he did not solicit the privilege, and was no party to it when granted."[1]

§ 1879a. Some Contractual Basis Necessary. — But in all these cases, there must, in order to charge the supposed shareholder either in behalf of the corporation for assessments, or in behalf of the creditors after insolvency, be some *basis of contract*, at least colorable; otherwise there is nothing by which to determine the extent of his liability. And herein a corporation, where the liability of members is restricted, differs from a partnership where that liability is unrestricted: in the latter case a person may undoubtedly be charged by acts of estoppel alone.[2] We must therefore conclude that acts of estoppel such as are considered, in the case of members of corporations, extend no further than to validate voidable contracts of subscription or membership. Most of the holdings become very simple when this distinction is kept in view. Thus, a subscription for shares was made by A. for and in the name of B. Here B., by accepting the office of director, to which he was not eligible if not a stockholder, recognized the validity of the subscription.[3] In another case governed by the same principle, A. became a director and vice-president of a national bank, and assumed the active management thereof.

[1] Hampshire *v.* Franklin, 16 Mass. 76, 87, per Parker C. J. This language was quoted with approval by Collier, C. J., in Selma &c. R. Co. *v.* Tipton, 5 Ala. 787; *s. c.* 39 Am. Dec. 344, 356. The ruling is in conformity with the previous decision of the same court in Ellis *v.* Marshall, 2 Mass. 269, *s. c.* 3 Am. Dec. 49, where it appeared that the legislature had incorporated certain persons named for the purpose of making a street, and had subjected them to assessment by the corporation for the expenses of making such street, and it was held that a person named in the act could not be bound unless he had assented thereto. It was said by Parker, C. J. (p. 276), in giving judgment in that case: "If it be a private act, obtained at the solicitation of individuals, for their private emolument, or for the improvement of their estates, it must be construed, as to its effect and operation, like a grant. We are all of opinion that this was a grant or charter to the individuals who prayed for it, and those who should associate with them; and all incorporations to make turnpikes, canals, and bridges, must be so considered." And the conclusion was that the legislature could not force a person to become a member of a strictly private corporation without his consent.

[2] Selby *v.* McCullough, 26 Mo. App. 66; Gates *v.* Watson, 54 Mo. 585; Rimel *v.* Hayes, 83 Mo. 200.

[3] Penobscot R. Co. *v.* Dummer, 40 Me. 172; *s. c.* 63 Am. Dec. 654.

The statute required such an officer to be a shareholder. Certain shares were transferred to A.; but, as he claimed, without his knowledge, until a large dividend was declared, when he returned the dividend to the assignor of the shares. The declaration of the dividend was a fraud, the bank being insolvent. It was held that A. must be deemed a shareholder, and liable as such.[1] But in this case, if no shares had ever been transferred to A., and if he had never subscribed for any or purchased any, by himself or otherwise, he could not have been charged as a shareholder.

§ 1880. Renders Non-compliance with Formalities Immaterial. — It was held by Lord St. Leonards, in a well-considered case, that if directors, not following the formalities prescribed by the deed of settlement, adopted, in respect of a particular transaction, and for the purpose of constituting shareholders, a new rule of proceeding, and a party treats himself, and is treated by the directors, as a shareholder by virtue of such a transaction, it is not competent for the directors subsequently to repudiate the transaction on the ground of non-compliance with the formalities required by the deed of settlement.[2] Upon like grounds a subscriber to the stock in a proposed company, who is present at the first election and is there elected a director, and acts as such, will not afterwards be permitted, in a suit against him by the company for a call, to deny the validity of its organization, on the ground that no notice of such election was given, and that some of the subscribers did not attend.[3]

§ 1881. Evidentiary Character of Particular Facts. — Evidence of membership, in actions by the corporation for calls, has been found in the fact of the defendant subscribing for certain shares, the clerk of the corporation entering his name upon its records as a shareholder in respect of the number of shares so subscribed, and the subsequent *declaration* of the defendant that he had taken the shares.[4] Signing a subscription list headed "Railroad stock taken at, etc., in the" [name of the railroad

[1] Brown *v.* Finn, 34 Fed. Rep. 124.

[2] Straffon's Executors' Case, 1 De G. M. & G. 576.

[3] Schenectady &c. Co. *v.* Thatcher, 11 N. Y. 102. See *ante*, § 1849, *et seq.*

[4] New Hampshire &c. R. Co. *v.* Johnson, 30 N. H. 390; *s. c.* 64 Am. Dec. 300.

company], under which is written the names of the subscribers and the number of shares taken by each; and afterwards participating in the election of directors and making partial payments on his subscription,[1]—these facts are evidence to charge the defendant in an action for assessments. Holding a meeting, effecting a temporary organization, electing officers, subscribing for stock, and adopting articles of incorporation at a subsequent meeting, where articles are on record in compliance with the governing statute,—creates the relation of stockholder among the co-adventurers.[2] According to the theory of some courts, participating in the affairs of the company as a stockholder, as by voting at corporate elections, serving as a director, etc., is not merely evidence tending to show membership, but it is *conclusive evidence* of membership, on the theory of *estoppel*.[3]

§ **1882. Exceptional Cases.** — But this rule has not been universally applied. Thus, where the governing statute gave the option to the husband of a female shareholder, or to the executor of a deceased shareholder, to become a member on complying with certain requisites, and the husband received dividends and receipted for them in the name of his wife, and attended meetings at which none but shareholders were entitled to be present,[4] and where an executor received a dividend which accrued after the death of his testator,[5] neither of them was held liable to respond to creditors of the company. These cases, and also Bosanquet *v.* Shortridge,[6] elsewhere cited, cannot, it is thought, be appealed to as establishing an exception to the general rule just stated. In a well-reasoned case in equity, involving similar questions, they were treated by Lord St. Leonards

[1] Fry *v.* Lexington &c. R. Co., 2 Metc. (Ky.) 314.

[2] Heald *v.* Owen, 79 Iowa, 23; *s. c.* 44 N. W. Rep. 210.

[3] Hays *v.* Pittsburgh &c. R. Co., 38 Pa. St. 81. Such evidence, it is added, is *primary*, and not secondary. *Ibid.* Evidence to warrant the finding that the party was a member of an *unincorporated joint stock company* has been found in the act of describing himself in a bill in equity as a surviving partner; signing a note with the other members, to raise money for the business, and also a power of attorney to sell real estate, and attending a meeting of the association, etc. Mechanics' Bank *v.* Dean, 124 Mass. 81.

[4] Ness *v.* Angas, 3 Exch. 805.

[5] Ness *v.* Armstrong, 4 Exch. 21.

[6] 6 Exch. 698.

as depending upon the terms of a particular statute,[1] which, though referring to equitable as well as legal liabilities, did not furnish a particular remedy for equitable liabilities. A man could not, he thought, be proceeded against by *scire facias* under the particular provisions of that act, unless it could be shown that he was *legally* liable as a member.[2]

§ 1883. **Estoppel to Deny Validity of Shares.** — A person who accepts shares in a company, executes the deed of settlement, for several years receives dividends declared on the shares, and, after the company has been ordered to be wound up, is called on as a contributory, is estopped by his contract and by his conduct from denying the validity of the shares.[3] So, where the directors of a company made an unauthorized issue of shares beyond their capital, but their acts were afterwards ratified by the company at a general meeting, the allottees of such shares were bound by the confirmatory resolution, and, on the winding up of the company, were rightly placed on the list of contributories.[4] So, it has been held in this country that one who purchases shares in a corporation, and knowingly suffers his name to appear on the books as a shareholder, cannot, in a proceeding to enforce his individual liability, under a statute providing that the word "stockholder" shall be understood to mean, not only such persons as appear from the books of the corporation to be such, but also every equitable owner,—impeach his own title by showing that the stock was improperly purchased by the corporation and issued to him.[5]

§ 1884. **Further of this Principle.** — Under the operation of this principle a subscriber may make a subscription otherwise bad for want of sufficient *formality* or *certainty*, good by conduct which has the effect of ratifying or validating the same, and estopping him from setting up the informality, — as where he afterwards acts as a stockholder and accepts the office of director.[6] So, as already seen,[7] although the shareholder was induced

[1] 7 Geo. IV. c. 46.

[2] Straffon's Executor's Case, 1 De G. M. & G. 589.

[3] Hull Flax and Cotton Mill Co. *v.* Wellesby, 6 H. & N. 38.

[4] Sewell's Case, L. R. 3 Ch. 131.

[5] Matter of Reciprocity Bank, 22 N. Y. 9, 17.

[6] Lane *v.* Brainerd, 30 Conn. 565.

[7] *Ante*, § 1377.

to become such by fraudulent representations of the officers of the corporation, yet if he afterwards attends corporate meetings, and takes part in the affairs of the corporation,—as by voting to increase the capital stock, voting for the declaration of dividends, receiving a dividend, and doing nothing for the period of six months to repudiate his relation as a stockholder, he will become estopped to rescind his subscription on the ground of fraud, as against the creditors of the corporation after it has become insolvent.[1] And where certain persons became subscribers to the stock of a corporation upon a promise by the president to take their stock off their hands when they should require it, it was held that there was no reciprocity in the agreement, and that the subscribers could not, after retaining the stock until the concern proved disastrous, call upon the president to fulfill his promise.[2] So, it was held that an incorporator of a turnpike road company, who took an active part in effecting a *change in the route* of the road, and, after the change was made, promised to pay his subscription to the stock of the company, could not repudiate his subscription on the ground of the indefiniteness of the object of incorporation as expressed in the articles.[3]

§ 1885. Theory that Stockholder may Repudiate Ultra Vires Shares. — So, a stockholder is not estopped to deny the validity of certain shares issued under a scheme to *increase the capital* stock of the corporation, although he voted for the arrangement. For, although a stockholder cannot set up *informalities* in the issue of stock which the corporation has the power to create,[4]— yet where the corporation is absolutely without power to increase its capital stock beyond a certain limit, the acquiescence of the shareholder can neither give it validity nor bind him or the corporation.[5] So, it is said by an eminent writer: "A distinction must be made between the shares which the company had no power to issue and shares which the company had power to

[1] Duffield v. Barnum Wire &c. Works, 64 Mich. 293; s. c. 31 N. W. Rep. 310; 7 West. Rep. 606.

[2] Slee v. Bloom, 19 Johns. (N. Y.) 456, 482; s. c. 10 Am. Dec. 273.

[3] Owenton &c. Turnpike Road Co. v. Smith (Ky.), 13 S. W. Rep. 426.

[4] Upton v. Tribilcock, 91 U. S. 45; Chubb v. Upton, 95 U. S. 665; Pullman v. Upton, 96 U. S. 328.

[5] Scoville v. Thayer, 105 U. S. 143.

issue, although not in the manner in which, or upon the terms upon which, they have been issued. The holders of shares which the company has no power to issue, in truth had nothing at all, and are not contributories."[1]

§ 1886. Notwithstanding the Acts of Agents of the Company.—If the stockholder is not in such a case estopped by his own acts from repudiating an *ultra vires* issue of shares, for stronger reasons he is put under no such estoppel by the acts of agents of the company in representing by public advertisements that the company has a capital stock equal to that which would result from the *ultra vires* increase. Said the court: "The laws secured to the public and the creditors an infallible mode of ascertaining the real capital of the company. They were bound to know that the law permitted no such increase of its capital stock as the company had attempted to make, and that any representation that it had been made was false. As forcibly suggested by counsel, a creditor, who has been defrauded by misrepresentation of the real capital of the company, has his remedy in an action of tort against all who participated in the fraud. But the wrong done to him cannot entitle the entire body of creditors, who have not suffered from the alleged fraud, to recover of the entire body of stockholders who have taken no part in it. We are of opinion, therefore, that the defendant is not estopped by the acts of the agents and officers of the company to allege the nullity of the overissue stock, and his non-liability to an assessment on such void stock."[2]

§ 1887. As in Case of a Void Amalgamation.—Where an amalgamation of two companies has been attempted, and, in pursuance of the scheme of amalgamation certain shareholders of the A. company apply for and have allotted to them their quota of shares in the B. company, and the amalgamation is afterwards judicially determined to be void, such shareholders of the A. company will not be estopped, by their conduct or acquiescence in the arrangement, from afterwards denying that they are

[1] 2 Lind. Part., 1st ed. 138. And see Lathrop *v.* Kneeland, 46 Barb. (N. Y.) 432; Mackley's Case, 1 Ch. Div. 247.

[2] Scoville *v.* Thayer, 105 U. S. 143.

shareholders in the B. company.[1] Nor, in case of a void amalgamation, will the fact that two of the directors of the selling company, to whom shares had been allotted in exchange for shares in the purchasing company, acted under the terms of the agreement as directors of the purchasing company, estop them from denying their liability as contributories of the purchasing company.[2]

§ 1888. Otherwise in Cases of a Good Amalmagation or Reorganization.— But of course the principle of estoppel under discussion applies in cases where there has been valid consolidation or organization. This may be illustrated by a case where, on the reorganization of a national bank, the defendant subscribed on the basis of a total subscription of $500,000, while the actual increase of stock was but $461,000. The defendant protested and refused to vote on the stock issued to him, but retained his certificate until the bank passed into the hands of a receiver several months afterwards. It was held that his acceptance and retention of the certificate constituted a ratification which precluded him from contending against his liability.[3]

§ 1889. Evidence not Sufficient under this Rule. — On the other hand, the mere *recital in a bond* that the obligor has retained as a loan a certain amount of his subscription in an educational corporation, has been held no evidence of the fact of a subscription; [4] but if not, why not? On what principle can it be held that a man's solemn admission, over his own signature, is not evidence against him? Such a paper itself might be regarded as an informal subscription.[5] It has been held that the

[1] Bank of Hindustan *v.* Alison, L. R. 6 C. P. 54; *ante*, § 354.

[2] Stace & Worth's Case, L. R. 4 Ch. 682.

[3] Butler *v.* Aspinwall, 33 Fed. Rep. 217. See also Buford *v.* Northern Line Packet Co., 69 Mo. 611; Clarke *v.* Omaha &c. R. Co., 4 Neb. 458; *ante*, § 358.

[4] Butler University *v.* Scoonover, 114 Ind. 381; *s. c.* 5 Am. St. Rep. 627.

[5] For evidence on which it was held that a finding of a court of admiralty that certain persons were *not* members of the corporation would not be disturbed, see McAdams *v.* Boyer, 37 Fed. Rep. 73. Validity of bond and mortgage given for shares before legal organization of the company; invalidity of same as to wife of principal obligor: Valk *v.* Crandall, 1 Sandf. Ch. (N. Y.) 179. Facts stated, on which it was held, that the relation of a certain corporation to

stockholder is not estopped from objecting to the cancellation of his shares because an amendment to the by-laws, made before he purchased his stock, authorized the directors to set aside certain money for the cancellation of certain shares, or because a subsequent amendment, authorizing a forced cancellation of shares, was submitted to by *other stockholders*, and he shared in the benefits accruing to the association.[1]

§ 1890. Effect of Passive Acquiescence, Laches and Lapse of Time. — So, although the person may not have done any *affirmative acts* which he could only do in the character of a shareholder, yet he may become equally estopped by a mere passive acquiescence with knowledge, where the rights of creditors have intervened. Accordingly, one who purchased stock in a bank and voluntarily suffered his name to appear as a stockholder on the books, cannot, in proceeding to enforce his individual liability under the statute, impeach his title by showing that the stock was improperly purchased by the bank and reissued to the defendant.[2] So, it has been held, that a purchaser of *preferred stock* which has been issued without express statutory authority, who has voluntarily subscribed and paid for it for the purpose of promoting the scheme under which it was issued, and who was a promoter of the scheme, cannot hold it for twenty-eight months after the conditions upon which it was issued have been fulfilled, and then, on the insolvency of the company, assert the invalidity of the stock, and recover back his money.[3]

§ 1891. Acquiescence of the Corporation Estops it from Denying Validity of the Subscription. — This principle of estoppel works against the corporation, as well as in its favor and in favor of its creditors. When, therefore, the directors and other agents of a company have for many years acquiesced in a subscription for stock, made by a person in the name of his children or others, who have exercised acts of ownership over it,

its stockholders was that of a *trustee* to a *partnership*; that the capital stock should be treated as partnership assets, and divided accordingly: Shorb *v.* Beaudry, 56 Cal. 446.

[1] Bergman *v.* St. Paul Mut. Building Assoc., 29 Minn. 275.

[2] Matter of Reciprocity, Bank, 22 N. Y. 9; Berry *v.* Matthews, 1 Ga. 519.

[3] Bard *v.* Banigan, 39 Fed. Rep. 13.

and voted on it without objection as their own, the corporation will not afterwards be allowed to treat the subscription as if it were a fraudulent use by the original subscriber of mere names to secure a greater number of votes than he would be entitled to if the stock stood in his own name.[1] An allotment of shares by directors of a company to subscribers, which was invalid because a sufficient number of directors were not present at the meeting, becomes valid when ratified by a subsequent meeting at which all the directors are present, if the application for the shares has not been revoked or the allotment repudiated.[2] In respect of the *time* within which the ratification just spoken of can take place, it was held that it was made within a reasonable time where the delay was from October 22 to January 16, the subscribers not having disaffirmed in the meantime.[3]

§ **1892. Operation of this Principle where the Shareholder has been Released.** — This principle will also operate to exclude those who have retired from the corporation, in case they desire to go back when they find that the corporation has become prosperous; and to hold them where, after being released, they have returned, and find themselves in when the corporation collapses. Accordingly, it has been held that a stockholder who has practically retired from and been treated by the other stockholders as out of the business, and who has not been called upon to contribute on account of liabilities during a number of years when the business was unprofitable, is *estopped*, after the corporation has been put upon a paying basis by the contribution of fresh capital by the other stockholders, to claim the right to *share in the profits*, when he did not assert his right or proffer his share to the new venture at the time of *reorganizing*.[4] On the other hand, where a subscriber to the capital stock of a railroad company who has been released from the obligation of his subscription subsequently votes at an annual election for directors, is himself elected a director, acts as a director and as a stockholder, and pays money to the company, his acts warrant the inference that he has resumed his

[1] Creed *v.* Lancaster Bank, 1 Ohio St. 1.

[2] Re Portuguese Consol. Copper Mines, 45 Ch. Div. 16.

[3] *Ibid.*

[4] Huston's Appeal, 127 Pa. St. 620; *s. c.* 18 Atl. Rep. 419.

original obligation; but this inference may not prevail where a special contract accounting for his acts is shown.[1]

§ 1893. **Subscription Prior to Incorporation Good without Acts of Ratification.** — On the other hand, and in conformity with the doctrine elsewhere stated,[2] a subscription to the capital of a proposed corporation will be good, so as to inure to the company when formed and enable it to maintain an action to enforce it, without any further acts of acquiescence or estoppel on the part of the subscriber. Thus, a subscriber in a park association who failed to attend a publicly advertised meeting of the subscribers, which appointed a committee to buy the land, procure the charter, call in subscriptions, etc., was held liable for his subscription at the suit of the corporation; the corporation being the legal trustee to receive and administer the fund subscribed.[3]

§ 1894. **Conduct Showing Membership.** — Next let us specify certain acts of participation in the affairs of the company which have been held to afford evidence to charge the stockholder, and in many cases *conclusive evidence* on the principle of estoppel. It is scarcely practicable to separate these acts of estoppel as they are catalogued in the different cases, because, in most of the cases, several of them occur together.

§ 1895. **Paying Calls.**— The mere fact of paying calls, if the alleged shareholder does nothing more, rests on a ground, scarcely different from that already considered,[4] of passive acquiescence with knowledge that his name is borne on the books of the company. It was held that paying calls will *estop* an original subscriber for shares,[5] or an unregistered transferee,[6] from denying his liability in a suit for future calls; for, by thus contributing to the actual working capital of the company, the contributor becomes entitled to share in its profits, if any should be made; and, as a consequence, becomes, in case of a joint-stock

[1] Pittsburgh &c. R. Co. *v.* Stewart, 41 Pa. St. 54.

[2] *Ante*, § 1224, *et seq.*

[3] Shober *v.* Lancaster County Assoc., 68 Pa. St. 429.

[4] *Ante*, §§ 1454, 1890.

[5] Frost *v.* Walker, 60 Me. 468; Inter-Mountain Pub. Co. *v.* Jack, 5 Mont. 568.

[6] Hall *v.* United States Ins. Co., 5 Gill (Md.), 484; Mississippi &c. R. Co. *v.* Harris, 36 Miss. 17.

company, a partner in the concern, and as such, liable to its creditors.[1] On the other hand, one who subscribes for stock in a company is a stockholder, although he may have failed to pay calls thereon;[2] he cannot, of course, plead his own default in discharge of his contract.[3] Conduct on the part of A., ratifying the act of B. in subscribing for shares of railway stock for A. and paying the necessary *deposit* on it, has been successfully appealed to fix A. with liability as a stockholder.[4] So, in a suit brought against a stockholder to recover an assessment made under a statutory provision, he will be regarded as having waived the right to object that the whole number of shares fixed and limited by the corporation was not subscribed for, if he has paid for the stock for which he subscribed.[5] On the other hand, it has been held that the mere fact that a stockholder in a manufacturing company, formed under the Maryland Code, art. 26, pays his subscription, knowing that the whole capital stock has not been paid in, and that the company is incurring debts for property and materials, is not such an act of participation as will estop him when sued by a creditor of the company, from setting up as a defense the partial subscription of the capital stock.[6] And even where the calls have been issued by a board of directors not properly constituted, yet if the stockholder pays such calls, his act will be construed as showing an acquiescence in their conduct, past and future, so as to cut off subsequent objections.[7] Moreover, it has been held that if a subscriber to stock of a railroad company acquiesce in the progress of the work, by payment of his subscription, assessed or otherwise, he cannot afterwards object, either to the failure originally to get subscribers to the whole stock, or to a material amendment of the charter; but the fact that he merely pays his assessments to have the route surveyed is not sufficient to show such

[1] Frost *v.* Walker, 60 Me. 468, per Walton, J.

[2] Schaeffer *v.* Missouri Home Ins. Co., 46 Mo. 248; McHose *v.* Wheeler, 45 Pa. St. 32.

[3] See *ante*, § 1524; *post*, § 1978. *Contra*, Fiser *v.* Mississippi &c. R. Co., 32 Miss. 359; Hayne *v.* Beauchamp, 5 Smed. & M. (Miss.) 537; Lewis *v.* Robertson, 13 Smed. & M. (Miss.) 538.

[4] Mississippi &c. R. Co. *v.* Harris, 36 Miss. 17.

[5] Ossipee Manuf. Co. *v.* Canney, 54 N. H. 295; *ante*, § 1242.

[6] Garling *v.* Baechtel, 41 Md. 305.

[7] Macon &c. R. Co. *v.* Vason, 57 Ga. 314.

acquiescence. And where the question of acquiescence has been fairly submitted to the jury, and has been passed upon by them, with evidence enough to sustain the verdict, the appellate court will not interfere.[1]

§ 1896. Serving as a Director. — In almost all known schemes of incorporation the directors can only be chosen from the body of shareholders, and in some of them, notably some of the English companies, no person is eligible to the office of director unless he is the owner of a certain number of shares, which, for that reason, have acquired the name of "qualification shares."[2] It clearly follows that serving as a director is *prima facie* evidence that the person is a shareholder to some extent, and where such a qualification as that above stated is prescribed, and also the extent of the number of shares necessary to qualify him so to serve, it is *prima facie* evidence that he is the holder of that number of shares.[3] It is easy, therefore, to conclude that an irregular subscription is validated by serving as a director, on the principle of waiver.[4] Some holdings go further, to the extent that where, after subscribing to shares in a corporation, the subscriber serves as a director therein, he is thereby *estopped* from denying its corporate existence, and also, as against its creditors or their representative, from denying the validity of his subscription.[5] If the company is unincorporated, so that the members are liable as partners, evidence that a particular person has attended its meetings, acted as a director, and inspected its works when in progress, — will be sufficient to charge him, on a similar principle.[6]

§ 1897. Serving a Corporate Office which can only be Filled by a Shareholder. — For the same reasons, the same effect is ascribed to the act of serving in any other corporate office which can only be filled by a shareholder. For instance, in almost all schemes of incorporation the *president* can only be chosen from the body of the directors, and the directors can

[1] Memphis Branch R. Co. *v.* Sullivan, 57 Ga. 240.

[2] *Ante*, § 1260.

[3] *Ante*, § 1260.

Lane *v.* Brainerd, 30 Conn. 565.

[5] Ruggles *v.* Brock, 6 Hun (N. Y.), 164.

[6] Maudslay *v.* LeBlanc, 2 Car. & P. 409.

only be chosen from the body of the shareholders. It follows that the president must, of necessity, be a shareholder. Hence, the fact that a person is elected to the office of president of the corporation and acts as its president, is at least *prima facie* evidence that he is a shareholder therein.[1] When, therefore, a person who had signed a paper agreeing to take a certain sum in the stock of a corporation, retained the paper in his possession, but produced it frequently at the meetings of the directors, where it was treated as a subscription, in the meantime being *president* of the company, it was held that such retention of the paper by him, as the chief officer of the company, did not have the effect of showing that he became a stockholder, as against a creditor, of the company.[2]

§ 1898. When the Principle Works to Exclude the Shareholder from the Company. — On the same principle a man may *lose his shares* by estoppel as against a creditor of another person — not of the corporation — by allowing such other person to use his shares as "qualification shares" for the office of director. When, therefore, a shareholder in a national bank placed part of his shares in the hands of a third person to hold for him, under a secret declaration of trust, and allowed such third person to be elected a director in virtue of those shares, and to take the oath required by the national banking law, that he was the *bona fide* owner of them, — it was held that he was estopped from denying that such actual holder was the owner of the shares, as against a creditor who trusted the holder on the faith of his being such owner.[3]

§ 1899. Illustrations of the Foregoing. — A person who had paid six several installments on shares in a company, who had transferred shares to others, who had acted as a director and president of the company, and had otherwise held himself out as a member, whereby he had induced official personages and private subscribers to act for his

[1] The presence of the defendant at the organization of the company, and his subsequent election and action as president, is evidence that he was a stockholder; the absence of the proper documentary evidence being first accounted for. Haynes *v.* Brown, 36 N. H. 545.

[2] Convith *v.* Culver, 69 Ill. 502.

[3] Young *v.* Vough, 23 N. J. Eq. 325.

benefit, was estopped, in an action by the company for calls, from denying that relation; and it was deemed wholly immaterial whether he had signed the subscription books or not. "Such," said the court, "is the genuine nature of estoppels, to exclude the truth."[1] Serving as director of a railroad company after the commissioner had reported to the governor of the State the names of the subscribers, including that of the person in question; serving as judge at a meeting of stockholders; holding himself out as the owner of a stated number of shares; offering to transfer some of them, and an active participation in a movement to procure a municipal subscription; — these acts were held to be, not merely evidential of an original subscription, but *conclusive*, estopping the persons so acting from denying the relation.[2] So, an act of Parliament,[3] to enable a company to construct a railway, prescribed the form of action against the proprietors for calls, and enacted that it should only be necessary to prove that the defendant was a proprietor, and that the calls had been made in pursuance of the act. It also recited that a sum of money had been subscribed by the proprietors under a contract binding their heirs; whereas, in fact, such sum had not been subscribed, and no contract under seal had been executed by the proprietors. It was held, in an action for calls, that a defendant who, with knowledge of the misrecital, had paid previous calls and acted as a proprietor, was estopped from questioning the validity of the act on the ground of the misrecital, and that it was not incumbent upon the plaintiff to show that the defendant had executed a contract under seal, in order to prove that he was a proprietor within the meaning of the act.[4]

§ 1900. Attending Corporate Meetings. — Attending, in the character of shareholder, a meeting of the members of a joint-stock company, at which important business was transacted, has been held sufficient *prima facie* evidence that the party was a shareholder to charge him with an engagement entered into by a majority of the shareholders, present at a *subsequent* meeting, which the shareholder in question did not attend.[5] A Canadian decision raises this evidentiary fact to the height of an estoppel, by holding that if the sharetaker has attended meetings of the company, he *cannot dispute* his being a shareholder, or say that

[1] Graff *v.* Pittsburgh &c. R. Co., 31 Pa. St. 489.

[2] Hays *v.* Pittsburgh &c. R. Co., 38 Pa. St. 81.

[3] 6 Geo. IV. c. 30.

[4] Cromford &c. R. Co. *v.* Lacey, 3 You. & J. 80.

[5] Harrison *v.* Heathorn, 6 Man. & G. 81.

he is not liable in respect of the shares for which he has thus subscribed.[1]

§ **1901. Voting as a Stockholder.** — Voting as a stockholder at corporate meetings, in respect of a given number of shares, has been held to estop the person exercising this privilege from denying that he is a shareholder, in any proceeding between himself and the corporation; and it is held that this estoppel not only acts in favor of the corporation itself, but inures to the benefit of its creditors, who, after the insolvency of the corporation, are subrogated to its rights as against its stockholders. The creditors in the particular case, became such prior to the time when the shares of stock were issued to the person proceeded against, so that there was no question of a direct estoppel operating between the creditor and the stockholder, as in the case of a creditor and a partner.[2] The subsequent overruling of this decision, as stated in the note, goes no further than to leave the doctrine in the position that voting as a stockholder is not in all cases an estoppel, but that it is an *evidentiary circumstance* which is subject to explanation; and in that case, as in others, wholesome doctrines have been to such an extent set aside by the judicial courts, in the interests of corporate managers, that it has come to be allowed that the same person can be, in respect of the same shares, *the corporation itself and its creditor;* that is, he may control the corporation by voting at corporate elections a majority of its stock held by him in pledge to secure its bonds issued to him, and at the same time not be a shareholder for the purpose of incurring any liability to creditors.[3] But the principle at least remains that voting as a shareholder validates an otherwise voidable subscription to the capital stock of a company, and is at least *prima facie* evidence that the person is a shareholder in respect of the number of shares ascribed to him on the corporate

[1] Port Whitby R. Co. *v.* Jones, 31 Up. Can. 170.

[2] 1 Wag. Stat. Mo. 300, § 6, subsec. 5; 1 R. S. Mo. (1879) § 717; Griswold *v.* Seligman, 72 Mo. 110. This decision was subsequently *overruled* by the same court following a decision of the Supreme Court of the United States: *post*, § 1902, note.

[3] This will fully appear from an explanation of the case given in the next section.

books.[1] Thus, a person, desiring to become a shareholder in a railway company, authorized one of the commissioners who had been appointed to take stock, to subscribe for him; his name was entered by another commissioner, who acted as clerk; the entry was certified by all the commissioners, and he afterwards *voted by proxy* as a shareholder. It was held, in an action by the company for calls, that he was liable.[2]

§ 1902. Doctrine that Pledgee of Shares does not make himself a Shareholder by Voting. — In a case which was afterwards overruled in Missouri, a railroad company, desiring to raise money to complete its road, entered into a contract with J. & W. Seligman, bankers, by which the latter agreed to make certain advances of money to the company, in consideration that the company should deposit with them its entire issue of mortgage bonds, and also a majority in value of the shares of its authorized capital stock. In pursuance of this agreement, the stockholders of the company passed a resolution "that in making negotiations for money with J. & W. Seligman & Company, certificates of a majority of stock be issued to J. & W. Seligman & Co., *to hold in trust* for the period of twelve months, and that such certificates be signed by the president and secretary with the corporate seal of the company affixed." On the stock books of the company the following entry was made: "J. & W. Seligman; Residence New York: shares 60,000, (*held in escrow;*) amount of dollars, $6,000,000, May 20th, 1872." The company became insolvent. Certain creditors, whose debts were created *prior to this transaction*, proceeded against the Seligmans as stockholders, under the Missouri statute allowing an execution against the stockholders of insolvent corporations in respect of the amount due to the corporation upon their shares. The statutes of Missouri relating to corporations contain the following provision: "No person holding stock in any such company, as executor, administrator, guardian, *or trustee*, and no person holding such stock *as collateral security*, shall be personally subject to any liability as stockholder of such company; but the person pledging such stock shall be considered as holding the same, and shall be liable as a stockholder accordingly; and the estates and funds in the hands of such executor, administrator, guardian or trustee, shall be liable, in like manner and to the same extent as the testator or intestate, or the ward, or person interested in

[1] That such an act is evidential only, and hence subject to explanation, see Pittsburgh &c. R. Co. *v.* Stewart, 41 Pa. St. 54.

[2] Greenville &c. R. Co. *v.* Coleman, 5 Rich. L. (S. C.) 118.

such fund would have been, if he had been living and competent to act, and held the same stock in his own name." [1] Notwithstanding this statute, the court held that the Seligmans were liable as stockholders. The decision proceeds upon two ideas: 1. That by *voting at corporate meetings*, as shareholders in respect of these shares, the Seligmans had, by their *conduct*, assumed the status of proprietors, and no longer stood in their position of mere pledgees. This position was strengthened by a statute which provides that "no person shall be admitted to vote on any shares belonging or hypothecated to the corporation." [2] 2. The other idea was that the statute contemplates cases where there is a responsible pledgor. It does not intend that the corporation can part with its capital stock to no one, for it would be absurd to say that a corporation could be its own stockholder. Therefore the Seligmans, by becoming pledgees or trustees of the stock of the corporation (which could not own its own stock, and which therefore could not stand as pledgor or *cestui que trust*, made themselves absolutely liable, at least so far as the rights of the corporation were concerned.[3] Where, how-

[1] 1 Wag. Stat., p. 301, § 9; R. S. Mo., § 771.

[2] 1 Wag. Stat. Mo. 300, § 6, subsec. 5; 1 R. S. Mo., § 717.

[3] Griswold *v.* Seligman, 72 Mo. 110. Opinion by Sherwood, C. J. Hough, J., concurred in the result. Norton, J., dissented on substantially these grounds: The Seligmans had made one contract with the railroad company, and, without imputing fraud to them, the court makes with them an entirely different contract. The Seligmans agreed to take these shares as collateral security for their advances, and did not agree to become contributories to the company as shareholders; but the court steps in and makes them contributories to the extent of $6,000,000, the par value of the shares. On the other hand, the argument of the chief justice is very cogent. Seligman & Co., by accepting and voting a majority of the shares of the railroad company, made themselves proprietors in the company, to use the language of the old books, part-owners, in a secondary sense, of this property. And they voluntarily assumed this position to escape the liabilities which the law attaches to it. Abundant authority could be produced in support of these opposing arguments. The decision, it is believed, reaches the justice of the case, and finds support in considerations of sound policy. The manipulation of the company's stock which took place in this case is believed to be one of the familiar methods by which American corporations are wrecked, and the rights of their shareholders and general creditors destroyed. It is to be observed that, prior to the rendition of the above decision, the St. Louis Court of Appeals decided the same question the other way (Fisher *v.* Seligman, 7 Mo. App. 383); but its decision was reversed by the Supreme Court on the authority of the above case. Fisher *v.* Seligman, 75 Mo. 13. Afterwards the decision of the Supreme Court of Missouri was followed by the St. Louis Court of Appeals, in Union Savings Association *v.* Seligman, 11 Mo. App. 143, — a case presenting the same facts; which last case was, in its turn,

ever, the person proceeded against as a stockholder merely claims to hold the stock in pledge, under a transfer from the real owner of the shares, he will, it seems, be concluded from setting up this fact when proceeded against as a shareholder by or on behalf of creditors of the company. Thus, in an action to enforce such liability of a stockholder, it appeared from the books of the corporation that the stock stood in defendant's name, and the evidence showed that he had voted on the stock, and had admitted that it stood in his name, but claimed that he held it as *collateral security* for a debt owing him by a third party. It was held that, whether he held it as security or as absolute owner was immaterial: he was liable.[1]

§ **1903. Giving a Proxy so as to Vote.** — It would seem to follow from this that the giving of a *proxy* to vote at a corporate election is *prima facie* evidence to charge the defendant as a shareholder; and so it was held in several cases.[2] Another court has held that one who having, by mistake, signed an alphabetical list of subscribers to the company, instead of the stock-subscription-book of the company, and who afterwards votes as a stockholder, is *estopped* to deny his subscription.[3] But the better view clearly is that the mere act of giving a proxy to vote at a corporate meeting is no more than an evidentiary circumstance, which may be explained, and made to appear consistent with the conclusion that the person did not become a shareholder. This will appear from a case where the defendant

reversed by the Supreme Court of Missouri on appeal (Union Savings Association *v.* Seligman, 92 Mo. 635), the court now (three judges against two) changing front and overruling its two former decisions on the same facts. In so doing the court followed, in the customary deferential fashion, a decision of the Supreme Court of the United States (Burgess *v.* Seligman, 107 U. S. 20) in which the last-named court declined, in its customary way, to follow the decision of the State court in the interpretation of its own statute, because that statute had not received interpretation at the hands of the State court at the time when the judgment of the Federal circuit court in the case was rendered. *Id.* p. 33. See *post*, § 5425.

[1] Sleeper *v.* Goodwin, 67 Wis. 577; *s. c.* 31 N. W. Rep. 335.

[2] In an action by a railroad company against a stockholder for installments, *a proxy* which the defendant, with others, had signed, as "stockholders," designating the number of shares opposite their names, respectively, was held to be *prima facie* evidence that defendant was a stockholder. Greenville &c. R. Co. *v.* Smith; 6 Rich. (S. C.) 91. To the same effect see McCully *v.* Pittsburgh &c. R. Co., 32 Pa. St. 25.

[3] St. Charles Manuf. Co. *v.* Britton, 2 Mo. App. 290.

agreed to subscribe to the stock of a company, providing a certain appointment was secured to him, but declaring at the same time that he could not then subscribe for the stock. He subsequently authorized the party soliciting for subscription to the stock to appear for him by proxy at the meeting of the stockholders, in anticipation of his future subscription to the stock, which was never made. It was held that the giving of such proxy was not a ratification, by the defendant, of the act of the one to whom it was given, in having signed the defendant's name on the stock-book of the company as a subscriber without his knowledge.[1] In another case a subscription for stock by a father in the joint names of himself and son was held not to be ratified by the son, by his mere act of intrusting a proxy to a person interested in the enterprise with instructions to use it only in a certain event, which not transpiring, it was destroyed unused.[2]

§ 1904. Participating in Management of Corporation. — The cases are numerous where persons who participate, in the character of stockholders, in the meetings of the corporation and in the conduct of its business, — voting at its elections, serving as directors, paying calls assessed against them in respect of stock, and in various other ways, — will be *estopped* by their conduct from denying their relation as stockholders and the validity of the assessments made against them as such, whether proceeded against by the corporation itself in an action for unpaid assessments while it continues a going concern, or by a receiver or other trustee for its creditors after its insolvency.[3]

[1] McClelland *v.* Whiteley, 15 Fed. Rep. 322.

[2] Ticonic Water Power Co. *v.* Lang, 63 Me. 480.

[3] Kansas City Hotel Co. *v.* Harris, 51 Mo. 464. Phœnix Warehousing Co. *v.* Badger, 6 Hun (N. Y.), 293; Haywood &c. Plank Road Co. *v.* Bryan, 6 Jones (N. C.), 82 (holding him although he had not paid the statutory deposit, see *ante*, § 1224); Greenville &c. R. Co. *v.* Woodsides, 5 Rich. (S. C.) 145; *s. c.* 55 Am. Dec. 708 (cutting off same defense); Tama Water Power Co. *v.* Hopkins, 79 Iowa, 653; 44 N. W. Rep. 797 (choking off his objection that the full amount of stock had not been subscribed; as to which see *ante*, § 1235); Garling *v.* Baechtel, 41 Md. 305 (choking off the same defense); Stillman *v.* Dougherty, 44 Md. 380 (same defense overruled); Rutz *v.* Esler &c. Manuf. Co., 3 Ill. App. 83 (acted also as *director*).

§ **1905. Illustrations.** — In an action for assessments by a corporation against a subscriber to its capital stock, it was alleged in the petition that the subscriber never had in fact signed the contract of subscription, but that, intending to sign such contract in which the conditions of the subscription were fully set out, he had signed by mistake a book containing merely an alphabetical list of subscribers to the company. He had subsequently participated in the organization of the corporation and had voted for directors. It was held on demurrer that, under these circumstances, he was estopped to say that he had not subscribed. It was immaterial that the meeting he had attended was before the incorporation; since a partner in an intended undertaking cannot repudiate the concern to which he has thus pledged himself after he has been a party to the measures taken to carry out the same. A person subscribing before the organization of a proposed joint-stock company raises a mutuality on his part which will render him liable to the company after incorporation. "If defendant," said the court, "intending to sign the agreement set forth in the petition, having read it over, had, by mistake, signed a blank sheet of paper, it would have been taken as an authorization and direction to write on the blank space the agreement he had intended to sign. He put down his name, intending to sign the conditions of subscription and to subscribe $1,000. He wrote that sum after his name, and he voted for directors of the company. He shall not now be heard to say that he did not subscribe." [1]

§ **1906. Illustrations Continued.** — It may be added that the Superior Court of Cincinnati — a tribunal of recognized ability, though not of final jurisdiction — has sustained by an able argument its judgment to the effect that a person who has paid an installment on stock allotted to him, and voted at a meeting of the corporation, is concluded from denying that he is a stockholder.[2] Upon analogous grounds, where a New England *parish* had voted that a certain person should be a member, and he had attended and had voted at the parish meetings, and had acted as trustee of the parish funds, he was held to be a member, so that his body could be taken in execution for a debt of the parish, although he had not filed any certificate of membership, in pursuance of the terms of certain statutes.[3] So, it has been held in Maryland that one who actively participates in the organization of a company, attends its meetings, serves as a director, is privy to the contracting of

[1] St. Charles Man. Co. *v.* Britton, 2 Mo. App. 290, 294.

[2] Dayton &c. R. Co. *v.* Hatch., 1 Disney (Ohio), 84.

[3] Chase *v.* Merrimack Bank, 19 Pick. (Mass.) 564; *s. c.* 31 Am. Dec. 563.

a debt by the company, will not be heard to deny that he is a shareholder in an action to enforce his individual liability as such.[1] So in New York, in an action to recover from the defendant a debt of a manufacturing corporation, on the ground that the capital stock had not been fully paid in, it appeared that the defendant had signed the articles of incorporation, had subscribed for stock, was a trustee and secretary of the corporation, and actively engaged in its management, and that his name was recorded in the corporation books as a stockholder. It was held that he was a stockholder, although he had neither paid for his stock nor received a certificate for it.[2] So in Kentucky, an incorporator of a turnpike company, who was active in effecting a change in the route, and thereafter promised to pay his original subscription, was bound by the changes made, and could not repudiate his subscription on the ground of the indefiniteness of the object of incorporation as expressed in the articles.[3] So in South Carolina, an association of persons, of whom A. was one, was formed to build a church. A. became owner of one of the pews, and at a meeting of the association, a resolution, seconded by A., was adopted, by which the pews were assessed at certain sums. Some months afterwards the association was incorporated. A. paid the assessment on his pew for several years, and then died, but his executors refused to pay some of the assessments after his death. It was held that A., by his acts, had recognized the resolution as one of the by-laws of the corporation, and was, therefore, bound to pay the assessment.[4] Again in New York, a voluntary association had become incorporated by an act of the legislature, and a majority of the members accepted the charter. It was held that a member who had united in the application for a charter, and had expressed no dissent thereto, could not repudiate it, though he was not present at the organization under the charter.[5]

§ 1907. Conduct Ratifying an Agreement to Take Shares in a Future Company. — An action may be maintained by a corporation against an original subscriber, on a promise made before the act of incorporation, if it is shown that he recognized it as binding, after the incorporation.[6] Upon similar grounds, a

[1] Hager *v.* Cleveland, 36 Md. 476.

[2] Wheeler *v.* Miller, 90 N. Y. 353.

[3] Owenton &c. Turnp. Road Co. *v.* Smith (Ky.) 11 Ky. L. Rep. 959; 13 S. W. Rep. 426.

[4] Vestry of Christ Church *v.* Simons, 2 Rich. (S. C.) 368.

[5] Ferris *v.* Strong, 3 Edw. Ch. (N. Y.) 127.

[6] Vestry of Christ Church *v.* Simons, 2 Rich. (S. C.) 368; St. Charles Man. Co. *v.* Britton, 2 Mo. App. 290; *ante*, § 1167.

person named as a corporator in the charter of a company, who signs a paper agreeing to take stock in a company to be thereafter organized, and who attends meetings of the company when organized, takes part in its proceedings, and offsets, in a settlement with the corporation, the amount due for his shares against an indebtedness of the corporation to him, — is deemed by his conduct to have made himself a stockholder, so that a creditor may charge him in that relation for the company's debt, without showing that he was a stockholder, from the company's books or from the sheriff's return.[1]

§ 1908. Acting as Member of Provisional Committee. — After much diversity of opinion,[2] the English courts have settled down upon the doctrine that the mere fact that a person acts as a member of a provisional committee, created for the purpose of getting up a joint-stock company, does not make him liable as a contributory in the event of the company being wound up.[3] This rule was applied in case of a provisional director and committee-man, to whom fifty shares had been allotted, who had attended the meetings and taken part in the proceedings, but who had never signed the subscription contract.[4] But a provisional committee-man, who had *accepted shares* in the company, was liable to be made a contributory, though he did not pay the deposit.[5] And where a provisional committee-man declined to take the shares allotted to him, and gave authority to the secretary of the company to withdraw his name from the list of the provisional committee, which, however, was not done; and although no shares were allotted to him, he *continued to attend meetings* of the committee and took part in the proceedings, and paid various sums of money, in pursuance of resolutions passed

[1] Chaffin *v.* Cummings, 37 Me. 76.

[2] Reynell *v.* Lewis, 15 Mee. & W. 517; Wilson *v.* Viscount Curzon, 15 Mee. & W. 577; Barnett *v.* Lambert, 15 Mee. & W. 489; Barker *v.* Stead, 3 C. B. 946; Bailey *v.* Macaulay, 19 L. J. (Q. B.) 73; Flemyng *v.* Hector, 2 Mee. & W. 172; Todd *v.* Emly, 8 Mee. & W. 505; Wood *v.* Duke of Argyll, 6 Man. & G. 928; Williams *v.* Pigott, 2 Exch. 204; Ex parte Besley, 2 Mac. & G. 176; *s. c.* 2 Ha. & Tw. 375.

[3] Norris *v.* Cottle, 2 H. L. Cas. 647, affirming Ex parte Cottle, 2 Mac. & G. 185; Robert's Case, 3 De G. & Sm. 205; affirmed, 2 Mac. &. G. 192; Hole's Case, 3 De G. & Sm. 241; *ante*, § 426, *et seq.*

[4] Maitland's Case, 3 Giff. 28.

[5] Hutton *v.* Upfill, 2 H. L. Cas. 674.

at those meetings, towards liquidating the liabilities of the company, he was held liable as a contributory.[1]

§ **1909. Receiving Dividends.** — Participation in the profits of a trading concern renders a man liable as a partner to third persons, whatever may be the stipulation of the partners *inter se*;[2] "for he who receives a share of the profits receives a part of that fund upon which the creditors of the concern have a right to rely for payment, and is, therefore, to be made liable to losses, although he may have expressly stipulated for exemption from them."[3] This general rule is, however, subject to very important qualifications, which it will not be necessary to notice here.[4] The analogous rule is that one who participates in the profits of a corporation by *receiving dividends* is held to be a shareholder,[5] and the equities attaching to his title are things with which the company and its creditors in general have nothing to do. He may hold as a pledgee[6] or as trustee for others,[7] and yet he will be a contributory.

§ **1910. Paying Calls, serving as Director, attending Meetings.** — So, where a subscriber to the capital stock of a railroad company, who had been released from the obligation of his subscription, subsequently voted at the annual meeting for directors, was himself a director, acted as a director and as a stockholder,

[1] Ex parte Besley, 2 Mac. & G. 176, affirming *s. c.* 3 De G. & Sm. 224.

[2] Grace *v.* Smith, 2 W. Black. 998; Waugh *v.* Carver, 2 H. Black. 235; *s. c.* 1 Smith's Ld. Cas. 968; Pott *v.* Eyton, 3 C. B. 32; Wightman *v.* Townroe, 1 Mau. & Sel. 412; Pond *v.* Pittard, 2 Mee. & W. 357; Berthold *v.* Goldsmith, 24 How. (U. S.) 536, 542; *Re* Francis, 7 N. B. R. 359; *s. c.* 2 Sawyer (U. S.), 289.

[3] Tindall, C. J., in Pott *v.* Eyton, 3 C. B. 32.

[4] See Bowas *v.* Pioneer Tow Line, 2 Sawyer (U. S.); 21; Hazard *v.* Hazard, 1 Story (U. S.), 375; The Crusader, 1 Ware (U. S.), 441; Bigelow *v.* Elliot, 1 Cliff. (U. S.), 33; Winship *v.* Bank of United States, 5 Pet. (U. S.) 562, 574; Phœnix Ins. Co. *v.* Hamilton, 14 Wall. (U. S.) 508.

[5] Hoare's Case, 2 John & H. 229; Gouthwait's Case, 3 De G. & Sm. 258; Philadelphia &c. R. Co. *v.* Cowell, 28 Pa. St. 329.

[6] *Post*, § 3213; Wheelock *v.* Post, 77 Ill. 296.

[7] *Post*, §§ 3193, 3194. That persons shared in the profits of a corporation which was not properly organized, by the receipt of dividends paid from time to time upon their respective shares of stock, does not alone amount to a ratification of the acts of the corporation, see Seacord *v.* Pendleton, 55 Hun (N. Y.), 579; *s. c. sub nom.* Merchants Nat. Bank *v.* Pendleton, 29 N. Y. St. Rep. 891.

and paid money to the company, — these acts, it was said, standing alone, would warrant the inference that he had resumed his original obligation as a stockholder; but they were deemed to be shorn of their importance in the particular case, since a special contract accounting for them was shown. The special contract was a parol promise of the president of the corporation that the company would take the amount of the subscriber's liability in cross-ties when the railroad should be constructed through his land; and as the case was an action by the company to enforce the payment of the subscription, the case was probably decided correctly.[1] So, where the charter of a company directed that a certain percentage should be paid at the time of making subscriptions to its stock, but the company organized, and permitted a subscriber to participate in its meetings and in the regulation of its affairs without paying such percentage, it was held, in a suit by the corporation for calls, that he could not afterwards disavow his membership and refuse to pay his subscription.[2]

§ 1911. Conduct Ratifying Subscription by Unauthorized Person. — Where a mere *intermeddler* subscribes the name of a person to the capital stock of a corporation, this act, of course, does not in any manner bind him; but it is not wholly void; it is capable of ratification; and, although mere declarations made to strangers by the party whose name had been thus unwarrantably used, to the effect that he had taken such shares, have been held insufficient, after his decease, to fix upon him the character of a stockholder so as to charge his estate,[3] yet a different effect has been ascribed to conduct tending to show that such person assumed the relation of stockholder and exercised the rights thereto appertaining; — as, where he authorized a proxy to vote his shares at a corporate election,[4] or remained silent for a long period after being informed that his name had been thus used,[5] or, long afterwards demanded and sued for dividends, alleging

[1] Pittsburg &c. R. Co. *v.* Stewart, 41 Pa. St. 54.

[2] Haywood &c. Co. *v.* Bryant, 6 Jones L. (N. C.) 82.

[3] Rutland &c. R. Co. *v.* Lincoln, 29 Vt. 208.

[4] McCully *v.* Pittsburg &c. R. Co., 32 Pa. St. 25.

[5] Philadelphia &c. R. Co. *v.* Cowell, 28 Pa. St. 329; *s. c.* 70 Am. Dec. 128.

that the subscription was authorized by him,[1] or, after being informed that his name had been entered as a shareholder and his deposit paid by another, frequently promised to pay the installments due on his shares.[2]

§ 1912. **The Person must be Held out as Shareholder with his Knowledge.** — In the foregoing cases the persons charged as shareholders, without reference to whether they had contracted to become so, had either actively interested themselves in the affairs of the corporation, or else knowingly permitted themselves to be held out to the public as shareholders. If a person not actually entitled to share in the profits of the company is held out as a shareholder without his knowledge or consent, of course this does not make him such. This is illustrated by a leading English case, where certain parties applied for shares, paid the first deposit, omitted to pay the second installment, and did not thereafter in any manner interfere with the concern. The directors advertised, after the time for paying the second installment had elapsed, that persons who had omitted to pay had forfeited their interest in the concern. These parties were subsequently sued in *assumpsit* for a debt of the company. The plaintiff contended that he had given the credit on the faith of the names of these shareholders being included in a book which the secretary of the company exhibited to him, at the company's counting-house, purporting to be a copy of the list of shareholders, — about 200 names arranged alphabetically, one leaf being assigned to each letter of the alphabet. This book the plaintiff had examined, though it did not appear that he had seen the names of the defendants therein. On these facts Tindal, C. J., held that the defendants were not liable; for, in the first place, there was no evidence that the defendants knew of the existence of any copy of the list at the counting-house; still less any evidence that such list was made up or shown to any one with their permission or knowledge. In his view, the holding one's self out to the world as a partner, as contradistinguished

[1] *Ibid.*

[2] Mississippi &c. R. Co. *v.* Harris, 36 Miss. 17. See also Penobscot &c. R. Co. *v.* Dummer, 40 Me. 172; *s. c.* 63 Am. Dec. 654, where the defendant had signed a written promise to take a certain number of shares.

from the actual relation of partnership, imports at least the voluntary act of the party so holding himself out. The persons, therefore, who contracted with the directors must rest upon the security of the directors who made such contract, and of those subscribers who, by executing the deed, have declared themselver partners, and of any who have, by their subsequent conduct, recognized and adopted the acts and contracts of the directors, — none of which acts could be imputed to the defendants.[1]

§ 1913. View that Others must have Acquired Rights on the Faith of the Acts of the Stockholder. — Some decisions assimilate the question so closely to the principles of equitable estoppels, as to rest their conclusion on the ground that other persons must have acquired rights on the faith of the acts of the shareholder; and where this appears, and such a person is seeking to hold him to his liability, of course the case is much stronger against him. Plainly, a stockholder who has participated in the adoption of *by-laws* and other corporate acts, which have been held out to the public as valid, is estopped from denying their validity to the prejudice of one who has acquired rights on the faith of them.[2] Where the question concerns the rights of creditors of a company which is nothing more than a numerous partnership, then there is room for the operation of the principle held by many courts,[3] that the advance must have been made by the creditor on the faith of the particular member being a shareholder. There is one case — and there are possibly others — which goes to the length of holding that it must affirmatively appear that the advances were made to the company on the personal credit of the shareholder sought to be charged. Lady Anson paid money for shares in a mine, to B., describing himself as treasurer of the mine, and received from persons calling themselves directors a memorandum purporting that she was a proprietor of shares, and that her name was entered in the "cost-book." She, in writing and in conversation, acknowl-

[1] Fox *v.* Clifton, 6 Bing. 776.

[2] People *v.* Sterling Manuf. Co., 82 Ill. 457.

[3] Bloch *v.* Price, 24 Mo. App. 14; Dowzelot *v.* Rawlings, 58 Mo. 76. Compare Graves *v.* Merry, 6 Cow. (N. Y.) 701; Deering *v.* Flanders, 49 N. H. 225; Martin *v.* Feewell, 79 Mo. 401, 412.

edged herself to be a shareholder, and received money from B., as treasurer, on account of supposed profits. An action was brought against her, as a shareholder, for supplies furnished the mine. It was not disputed that the defendant had regarded herself as a shareholder in the mine. Nevertheless the court held that not to be the question in the case; but, first, whether she actually had any interest in the mine, such that she could call upon the parties working the mine to account to her for a portion of the profits made, supposing profits had been made; or, secondly, supposing she had no interest in the mine, whether the supplies had been furnished on her personal credit. Neither of these points being made out, the plaintiff was non-suited, and, on argument, the rule made absolute.[1] But in the case of corporations American courts *presume* that others — either shareholders or creditors have acted on the faith of the particular person being in fact what he claimed to be. In so presuming they proceed in view of the obvious difficulty of proving the *motive* with which persons act, it being a matter for the most part within the breast of each individual. The only distinction which they take in respect of this question is that between prior and subsequent creditors, — a matter hereafter considered.[2]

§ 1914. Waiver by Conduct of Irregularity of Assessment.—We have already seen[3] that a person may make himself a shareholder by his *conduct* where the circumstances are such that he might disaffirm his engagement. So, he may by his conduct, validate an *irregular assessment*;— as by participating in a meeting called for the purpose of organization, submitting to be elected director and acting as such;[4] or by assisting in framing the by-law under which the assessments are levied, and voting for its adoption.[5] But an illegal assessment upon cor-

[1] Vice *v.* Anson, 1 Man. & R. 113. This case can, however, hardly be considered as authority. It has often been "distinguished" by the English judges in subsequent cases. One or two odd cases of this kind are to be met with in the books, upon reading which one can hardly divest his mind of the impression that the sex or social position of the party sought to be charged, or both, have outbalanced a colorless administration of justice.

[2] *Post*, § 2936.

[3] *Ante*, § 1377.

[4] Bucksport &c. R. Co. *v.* Buck, 68 Me. 81; *s. c.* 28 Am. Rep. 21.

[5] Willamette Freighting Co. *v.* Stannus, 4 Or. 261.

porate stock cannot be made good, upon the footing of contract, from an assent, to be presumed from assent to *former* illegal assessments of lesser amount; nor can such assent be given with effect by an assignor of stock, after an assignment of the stock and notice of the assignment given to the corporation.[1] The same rule applies to the matter of the non-payment of the *deposit* required to be paid when the subscription is made. If the act of incorporation requires the payment of $5 per share to the commissioners, and without such payment the subscription to be void, one sued for non-payment, who has exercised the right of a stockholder, by voting for managers, cannot set up such omission in defense.[2]

ARTICLE III. BOOKS AND RECORDS OF CORPORATION AS EVIDENCE.

§ 1918. Records of the Corporation Admissible against the Corporation. — The question under what circumstances and to what extent the records of the corporation are evidence of the fact of a particular person being a shareholder therein, is one on which there is much diversity of opinion, and the subject must

[1] Atlantic &c. Co. *v.* Mason, 5 R. I. 463.

[2] Clark *v.* Navigation Co., 10 Watts (Pa.), 364.

therefore be considered at some length. At the outset it may be stated that the records of the corporation, when duly proved to be such, are always admissible against the corporation itself, on the theory of being solemn self-disserving admissions of the corporation. For instance, they are evidence against the corporation to prove the fact of its organization and corporate existence.[1] In the opinion of some they operate as *conclusive admissions* or *estoppels* against the corporation, though, on principle, this view is not so clear. Thus, it has been held in Vermont that where the records of a corporation recorded in the town clerk's office, as required by law, show a certain person to be a stockholder, the corporation is estopped from introducing evidence to prove him not a stockholder.[2] It has been better observed that "when a corporation has proceeded regularly to ascertain its corporators, and the owners of shares in its capital, and has entered them in its records, all parties become thereby *prima facie* entitled to the rights thus secured to them. The records are competent and sufficient evidence of them, unless proof be introduced to destroy their effect."[3]

§ 1919. Books of the Corporation not Admissible to Connect a Stranger with the Corporation.— Perhaps no rule broad enough to cover all cases can be stated as to when, in an action to charge a shareholder, the books of the corporation are evidence against him. It may be stated that, *as between members* of the corporation, they are evidence of all corporate acts therein recorded; but they cannot be used against a stranger to connect him with the corporation,[4] unless made so by act of the legislature.[5] It is obvious that this must be the rule applied to the classes of actions we are considering. Otherwise the secretary of a company, by entering a man's name as a shareholder on its books, might, without his knowledge or consent, make him a stockholder; and where death or other circumstances had ren-

[1] Hudson *v.* Carman, 41 Me. 84.

[2] Stratton *v.* Lyons, 53 Vt. 130.

[3] Penobscot R. Co. *v.* Dummer, 40 Me. 174; *s. c.* 63 Am. Dec. 654; Penobscot R. Co. *v.* White, 41 Me. 512; *s. c.* 66 Am. Dec. 257.

[4] Greenl. on Ev., § 493; Ang. & Ames on Corp., 679; Chase *v.* Sycamore &c. R. Co., 38 Ill. 215; Mudgett *v.* Horrell, 33 Cal. 25; Fox's Case, 3 De G. J. & S. 465.

[5] Bristol Canal Co. *v.* Amos, 1 Mau. & Sel. 569.

dered countervailing proof impossible, this unauthorized act of another might charge him or his estate with a serious burden. Men should be allowed to make their own contracts; the courts should not, by establishing unreasonable rules, make contracts for them.[1] Accordingly, one who had subscribed for stock upon the condition, expressed in the contract, that it was not to be paid until $5,000 should be first raised, was held not to be a member of the corporation so as to make the books evidence against him in a suit for calls.[2]

§ **1920. Are Evidence of Acceptance of Subscription.** — They are also, for some purposes and to some extent, admissible *against an alleged stockholder* in an action by the corporation to charge him in respect of his alleged subscription to its capital stock. Thus, it has been held in such an action, that the minutes of a meeting of the directors of the corporation, while not *binding* on the alleged subscriber, are nevertheless admissible in evidence to show an *acceptance by the corporation* of his proposal to take stock.[3]

§ **1921. Test by Which to Determine their Admissibility.** — "In some cases, then, the test to be applied to the question whether the corporate records are admissible, upon these authorities, would seem to be whether the party against whom they are offered stands in such relation to the corporation that he is *chargeable with knowledge of the records;* whether, as to him, the books are in the nature of public books, he being connected with them in interest and of which he could demand and have inspection as of right; or whether he is a mere stranger, unconnected in interest, they being, as to him, private books, the inspection of which could not be compelled in his favor. In other cases the test to be applied would seem to be one not having reference to the character of the party, but to the nature of the matter which is the subject of record. In this view the

[1] See Mudgett *v.* Horrell, 33 Cal. 25.

[2] Chase *v.* Sycamore &c. R. Co., 38 Ill. 215. See, as to *conditional subscriptions*, Fort Edward &c. Co. *v.* Payne, 17 Barb. (N. Y.) 567; Morris Canal and Banking Co. *v.* Nathan, 2 Hall (N. Y.), 239; *ante*, § 1305, *et seq.*

[3] Colfax Hotel Co. *v.* Lyon, 69 Iowa, 683; *s. c.* 29 N. W. Rep. 780.

test is whether the matter recorded consists of corporate acts, involving the organization or existence of the corporation, or whether it is merely matter pertaining to some contract, property, or right not essentially involving the exercise of power under the corporate franchise."[1]

§ **1922. Admissible against Those Acting as Members.**— Thus, the records kept by the clerk of a railroad corporation of the proceedings of the directors, in ordering assessments upon the shares of the capital stock, may be used as evidence by the corporation, in a suit brought by them to recover an assessment upon the shares subscribed for by the defendant, he being one of the original grantees in the charter, and a director at the time the assessment was ordered, and having exercised the privileges of a stockholder in virtue of the shares upon which the assessment was made.[2]

§ **1923. To What Extent Explainable by Parol.** — But even if the books of a corporation can be received as presumptive evidence to prove that a particular person was a stockholder, such presumption may be overcome by *parol testimony* showing that he never accepted, but refused to accept, stock in the company.[3] But parol evidence will not be heard to show that a person had, at a certain time, by transferring his shares, *ceased* to be a stockholder; the books of the corporation only will be looked to.[4] An alleged subscriber, sued upon his alleged contract of subscription, may introduce extracts from the minutes of the proceedings of the company, in connection with oral evidence, in which appeared two statements of lists of subscribers without the defendant's name.[5]

§ **1924. View that Corporate Books Presumptive Evidence of Membership.**—On principle, the books and records of the corporation are not competent evidence to prove that the defendant

[1] White Mountains R. Co. *v.* Eastman, 34 N. H. 124, 137; opinion by Sawyer, J.

[2] White Mountains R. Co. *v.* Eastman, 34 N. H. 124, 137.

[3] Mudgett *v.* Horrell, 33 Cal. 25; Fox's Case, 3 De G. J. & S. 465.

[4] Stanley *v.* Stanley, 26 Me. 191; *post*, §§ 2375, 3283.

[5] Stuart *v.* Valley R. Co., 32 Gratt. (Va.) 146.

is a stockholder; for the general rule is that one party to an alleged contract cannot prove the existence of the contract by his own private memoranda or records.[1] The mere statement of this principle ought to be enough to convince one of its correctness without argument. A *judgment* is the most solemn instrument of writing known to the law; and yet a judgment against a person, in a proceeding to which he was no party, is not admissible in evidence against him for the purpose of disposing of his substantial rights,[2] though it may be admissible in particular cases and under particular issues, for the mere purpose of proving particular facts.[3] It is said to be *res inter alios acta*, something done between other persons, and which therefore does not affect him at all. If an instrument as solemn as a judgment cannot affect a stranger to it, how can one man make another man his debtor merely by marking him down as such in his own private books? And upon what principle can he put the stranger so marked down to the expense of defending a lawsuit in order to prove that he was marked down without his authority? In the face of this obvious truism, the Supreme Court of the United States have held that, where the name of an individual appears on the books of a corporation as a stockholder, the *prima facie presumption* is that he is owner of the stock, and the burden is cast upon him to show that such is not the fact.[4] Some of the State courts have also fallen into the same strange aberration.[5] The absurdity and injustice of this rule are shown

[1] See Hensgen *v.* Donnelly, 24 Mo. App. 398, and Anchor Milling Co. *v.* Walsh, 37 Mo. App. 567, on the question when books of account should be admitted in evidence.

[2] McKinney *v.* Guhman, 38 Mo. App. 344; Griffith *v.* Gillman, 31 Mo. App. 33; Holladay *v.* Menefee, 30 Mo. App. 207; Strauss *v.* Ayers, 87 Mo. 348.

[3] Cravens *v.* Jameson, 59 Mo. 68; Kane *v.* McCown, 55 Mo. 181; Walker *v.* Deaver, 79 Mo. 664; *s. c.* 5 Mo. App. 597.

[4] Turnbull *v.* Payson, 95 U. S. 418.

[5] In Maine it is held that the records of a corporation are competent and sufficient evidence to show who were the corporators and the number of shares that had been taken at the time of an assessment, unless some proof be introduced to destroy their effect. Penobscot &c. R. Co. *v.* Dummer, 40 Me. 172; *s. c.* 63 Am. Dec. 654. See also Heaston *v.* Cincinnati &c. R. Co., 16 Ind. 282. Lehman *v.* Glenn, 87 Ala. 618; *s. c.* 6 South. Rep. 44; Hoagland *v.* Bell, 36 Barb. (N. Y.) 57. Plank Road *v.* Rice, 7 *Id.* 162; Turnpike Road *v.* Van Ness, 2 Cranch C. C. 451; Mudgett *v.* Horrell, 33 Cal. 25; Coffin *v.* Collins, 17 Me. 440; Merrill *v.* Walker, 24 *Id.* 237.

by the statement that the person sought to be charged may discharge himself by proving that his name was entered on the books of the corporation as a stockholder without his authority.[1] If then, in a case where such is the fact, he through misfortune, lack of pecuniary ability or otherwise, fails to defend the action by which it is sought to charge him as a stockholder, a judgment goes against him on evidence which is manufactured by some person who is not even legally responsible for the wrong.

§ **1925. Further on This Subject.** — The view of the writer expressed in the preceding section, would not of course be the correct view where the book which is offered in evidence is one *to which the defendant is privy.* Thus, if it is the original subscription book, and what purports to be his name appears as a subscriber therein, and such book is the foundation of the action, and he does not deny his signature on oath, as required by the statute, the book is competent evidence against him, provided it is sufficiently identified; [2] and it has been held that it is sufficiently identified where the clerk of the corporation swears that it came to him together with the other books of the corporation.[3] So, where evidence has been given fixing the character of the defendant as a subscriber or stockholder, the books and records of the corporation are admissible for the purpose of proving that *an assessment* by the directors has been made, and the amount of the same; and indeed they are the *best evidence* of such facts.[4] Accordingly, where the defendant was shown to have been one of the original grantees named in the charter, and a director of the corporation at the time when the assessment was ordered, and that he had exercised the privileges of a stockholder in

[1] Mudgett *v.* Horrell, 33 Cal. 25.

[2] Breedlove *v.* Martinsville &c. R. Co., 12 Ind. 114.

[3] *Ibid.*

[4] The *books* of the corporation are admissible to prove the amount of the assessment against one who claims under an original corporator. Comfort *v.* Leland, 3 Whart. (Pa.) 81. Under Tex. Rev. Stat., Art. 586, requiring corporations to keep a record of all business transactions, and Art. 601, making such records or copies thereof, competent evidence, the best evidence of an assessment made by the directors is the record of the order or resolution of the board of directors. Guadalupe &c. Stock Assoc. *v.* West, 76 Tex. 461; *s. c.* 13 S. W. Rep. 307.

virtue of the shares on which the assessment was made, — there was, of course, no difficulty in holding that the records kept by the clerk of the corporation of the proceedings of the directors in ordering assessments were admissible in evidence against him.[1] Moreover, in such action the records of the corporation are competent evidence, generally the best evidence, to show that the corporation *has done certain acts*, proof of which may be material under the issues.[2] They may also be admissible to show that the *number of shares has been subscribed* to warrant the subscribers in proceeding with the organization of the corporation under the governing statute.[3]

§ 1926. Ordinary Mode of Making Proof in Actions for Assessments under this Rule. — In a case which went to the Supreme Court of the United States, and where the rule of the preceding section was declared, the following is found in the opinion of the court: "Two principal allegations were required to be proved by the plaintiff in order to maintain the action, which was *assumpsit* to recover the assessment made by the order of the bankrupt court: 1. That the defendant was a stockholder in the company, and that he owned fifty shares of the capital stock. 2. That the assessment had been made by the assignee, as alleged in the declaration. During the trial, the plaintiff offered evidence to prove that the defendant was a stockholder, as follows: 1. He offered the books of the corporation, in which the name of the defendant was entered as the owner of fifty shares. 2. He offered the stock-book of the company, with a duplicate of the stock certificate issued to the defandant, showing that he was the owner of the same number of the shares of the capital stock. 3. He introduced testimony to prove that the certificate was sent to the agents of the company, to be delivered to the defendant when he paid twenty per cent. of the shares; and that he made the required payment. 4. He also introduced a receipt signed by the defendant, showing that the company paid the defendant a dividend upon his stock. Separate objection was made by the defendant to each of the offers of proof, which were admitted by the court, and the defendant excepted. Taken as a whole, it is clear that the evidence offered was amply sufficient to warrant the jury in finding that the defendant was a stockholder, as alleged. Where the name of an individual appears on the stock-book

[1] White Mountain R. Co. *v.* Eastman, 34 N. H. 124.

[2] *Post*, Ch. 185, Art. I.

[3] Penobscot &c. R. Co. *v.* Dunn, 39 Me. 587.

of a corporation as a stockholder, the *prima facie* presumption is that he is the owner of the stock, in a case where there is nothing to rebut that presumption; and, in an action against him as a stockholder, the burden of proving that he is not a stockholder or of rebutting that presumption, is cast upon the defendant." [1]

§ 1927. Books Evidence in Case of Successive Transfers. — But where the shares have been transferred from one stockholder to another, and the question is, as between the successive stockholders, who shall be answerable to the creditors of the corporation, then, as hereafter seen,[2] the rule is that he whose name stands as shareholder on the corporate records must answer, although in fact another was the equitable owner, who has transferred it as a pledge to the person sought to be charged.[3]

§ 1928. Books Transcribed from Original Subscription Papers. — We have already seen that it is not necessary to the validity of a subscription to the stock of a corporation that the subscribers should sign their names in a *book* open for that purpose, but that their subscriptions will be good although taken on slips of paper and afterwards entered in the book.[4] By parity of reasoning when the subscriptions are shown to have been so made and so transcribed, the book will be evidence, in an action to charge an alleged subscriber, of the fact of his being such.[5] The plaintiff corporation may, it has been held, produce in evidence a subscription paper, by which the signers bind themselves to pay for the shares opposite their names, the plaintiff having

[1] Turnbull *v.* Payson, 95 U. S. 418, opinion by Clifford, J.

[2] *Post*, § 3193.

[3] Case of Empire City Bank, 8 Abb. Pr. (N. Y.) 192, 222; Holyoke Bank *v.* Burnham, 11 Cush. (Mass.) 183. See Crease *v.* Babcock, 10 Metc. (Mass.) 525. Grew *v.* Breed, 10 Met. (Mass.) 569. The *statutes of Maine* are to be construed as making the transfer books of a corporation *conclusive* so far as creditors are concerned, as to who are to be considered stockholders. Stanley *v.* Stanley, 26 Me. 191. But where the controversy is as to the right to *vote* at a corporate *election* under a statute of New York (603, Sec. 5), the court may go behind the entries in the transfer book of the corporation, and determine whether a transfer was a sale or only a pledge, and whether the pledgor or the pledgee was entitled to vote thereon. Strong *v.* Smith, 15 Hun (N. Y.), 222. But see *ante*, § 732, *et seq.*

[4] *Ante*, § 1151.

[5] Iowa &c. R. Co. *v.* Perkins, 28 Iowa, 281; Stuart *v.* Valley R. Co., 32 Gratt. (Va.) 146; Hayden *v.* Atlanta Cotton Factory, 61 Ga. 233.

stated its intention to show that the amount so subscribed was entered on its stock list and ledger. It may then introduce such stock ledger and shareholders' list compiled from subscription lists like the above, and from a memorandum, made by an agent appointed to collect quotas; and this, although the defendant offers to prove that he had withdrawn his proposal to subscribe before the books were in existence.[1] So where, in a suit by a corporation on a stock subscription, the defense was that the agreed number of shares had not been *bona fide* subscribed so as to make the subscription binding, it was held, that the original subscription book, made up by copying from lists which were carried around to solicit subscriptions, and accepted by the directors, was admissible.[2]

§ 1929. **An Illustration of the Foregoing.** — A meeting was held for the purpose of raising subscriptions to the stock of a railway company. The objects of the subscription and the terms and conditions were fully made known, and those present were solicited to subscribe. The names of the subscribers and amounts of the subscriptions were written by the parties soliciting upon a small book or slip of paper, upon the subscribers authorizing them so to do. The subscriptions were afterwards transcribed by an officer of the company into another book. In an action by the company upon the subscriptions to the stock, — it was *held*, that the *book into which the subscriptions had been transcribed* was properly admitted in evidence. The theory of the court was that the officer of the company was empowered by the subscribers, by the authority conferred at the meeting, to make the entries. The books and slips of paper, upon which the names and amounts were written at the meeting, were but memoranda of the authority conferred upon the officer of the company to make subscriptions in the name of the different parties agreeing to take stock in the corporation. The book admitted in evidence thus became the original contract of subscription, and was properly admitted without proof of the loss of the memoranda.[3]

§ 1930. **Effect of Failure to Deny under Oath.** — It is possible that under some remedial systems or acts of incorpora-

[1] Stuart *v.* Valley R. Co., 32 Gratt. (Va.) 146.

[2] Hayden *v.* Atlanta Cotton Factory, 61 Ga. 233.

[3] Iowa &c. R. Co. *v.* Perkins, 28 Iowa, 281.

tion, the corporation will not, in an action to enforce an alleged stock subscription, be required to prove the subscription, unless the defendant files a plea or answer in the nature of a plea of *non est factum*, by which he denies the alleged subscription under oath. Thus, in suits by a railroad company to recover calls upon the capital stock subscribed by defendant, it is not necessary for the company, under the Mississippi act of 1854, to prove a defendant's subscription as set forth in the complaint, unless he denies it under oath; and a plea denying the subscription but not under oath is not good.[1]

§ 1931. Not Evidence against a Stockholder in Respect of Private Dealings. — Nor are the books of a corporation admissible against a member, as evidence of his private contracts and dealings with the company, even in a suit against him by a creditor,[2] — as a "stock-book" introduced to show entries of assessments.[3]

[1] Thigpen *v.* Mississippi Central R. Co., 32 Miss. 347.

[2] Hager *v.* Cleveland, 36 Md. 476.

[3] Haynes *v.* Brown, 36 N. H. 545, 566. This case contains the following valuable discussion of the subject by Bell, J.: "The records of a corporation are evidence in some cases, and for some purposes. The rule generally laid down in the elementary books is that 'the books of a corporation, whether containing entries of a public or private nature, are admissible in evidence as between themselves, and not against a stranger.' 1 Saund. on Pl. & Ev. 851; Ang. & Ames on Corp. 607; 2 Ph. on Ev. 295. The present case is not one where the parties are members of the same corporation, and it is therefore unnecessary to inquire whether the rule is not laid down more broadly, or with fewer qualifications, than it ought to be. There is no question that the records of a corporation are evidence of the proceedings of the corporation itself (1 Greenl. on Ev., § 493; Highland Turnpike Co. *v.* McKean, 10 Johns. (N. Y.) 154; *s. c.* 6 Am. Dec. 324; Ang. & Ames on Corp., § 679; Wood *v.* Jefferson County Bank, 9 Cow. (N. Y.) 194, 205; Case of Thetford, 12 Vin. Abr. 90, pl. 16; Smith *v.* Steamboat Co., 1 How. (Miss.) 479; Whitman *v.* Granite Church, 24 Me. 236; Coffin *v.* Collins, 17 Me. 440; People *v.* Oakland County Bank, 1 Dougl. (Mich.) 282; as to its organization (Duke *v.* Navigation Co., 10 Ala. 82; *s. c.* 44 Am. Dec. 272; Hall *v.* Carey, 5 Ga. 239; McFarlan *v.* Insurance Co., 4 Denio (N. Y.), 392); of its meetings, and the election of its officers and members (Gibbon's Case, 17 How. St. Tr. 810, 814); and of the votes and acts of the corporation and its officers, where those acts and votes are required, either by the charter or by-laws, to be recorded; or where they are in fact transacted at meetings of those officers, at which there is a clerk to keep the records. To render these books admissible for these purposes, the party who introduced them must show that they are the books of the corporation, independently of what

§ 1932. Books of Account of the Corporation in Actions against Stockholders. — In actions by the corporation against the stockholder, for ordinary private demands where they have dealt together as individuals, the *books of account* of the corporation are admissible against the defendant, or not, on the same principles which would apply in case the action were against any other person: unless he is connected with them by other evidence than by merely showing that he is a stockholder, they are not in general competent evidence in themselves to establish an action or claim against him; and this has been held even in a case where the defendant was a trustee as well as a stockholder.[1]

§ 1933. Records of the Commissioners. — The reasoning which has been applied in the case where the books of a corporation are offered in evidence in an action by the corporation against one alleged to be a stockholder, would seem to apply, *mutatis mutandis*, to the case where the corporation is organized

appears upon the books themselves (Whitman *v.* Granite Church, 24 Me. 236); that they have been regularly kept by the clerk, or other proper officer (12 Vin. Abr. 90, pl. 16; Highland Turnpike Co. *v.* McKean, 10 Johns. (N. Y.) 154; *s. c.* 6 Am. Dec. 324; Rex *v.* Mothersell, 1 Stra. 93; 2 Ph. on Ev. 442); and if there is any thing suspicious in their appearance, or if any doubt is cast upon them by the testimony, that they were made at the times they purport to have been, and have not been made up subsequently, to answer some purpose of the corporation or others. But the entries in the books of a corporation, relating to other matters of fact than the proceedings of the corporation, are not evidence in their favor in a controversy between them and any stranger, nor between them and a member of the corporation, holding or claiming adversely to them. 2 Saund. on Pl. & Ev. 748; Ang. & Ames on Corp., § 679; 1 Greenl. on Ev., § 493. Neither are they evidence against a member of the corporation of his contracts or private dealings with the company. In that respect he is to be regarded as a stranger. 1 Ph. on Ev. 449; Hill *v.* Manchester Water-Works Co., 2 Nev. & Man. 573; *s. c.* 2 Barn. & Adol. 544. This principle was recognized in the case of Marriage *v.* Lawrence, 3 Barn. & Ald. 142; in Brett *v.* Beales, 1 Moo. & M. 416; Mayor of London *v.* Mayor of Lynn, 1 H. Black. 214, note c; Jermain *v.* Worth, 5 Denio (N. Y.), 342. As the books of a corporation are not evidence, as between the corporation and a member or a stranger, as to their business transactions, it follows *a fortiori* that they cannot be so between a member and a stranger, or between two strangers; and the cases of Brett *v.* Beales, Jackson *v.* Walsh [3 Johns. (N. Y.) 226], and Jermain *v.* Worth, before cited, are direct authorities to this point."

[1] Rudd *v.* Robinson, 126 N. Y. 113; *s. c.* 12 L. R. A. 473; 9 Rail. & Corp. L. J. 428; 36 N. Y. St. Rep. 500; 26 N. E. Rep. 1046.

by commissioners appointed under the governing statute, but with the distinction that greater sanction might attach to their records in view of the fact that they are generally regarded as *public officers*. But, as a party cannot be affected by a *judgment* to which he is no party,[1] so, it would seem on principle that he cannot be affected by the record of an official board of which he is not a member. In the case of a judgment, it is true that the proof that the defendant is a party is furnished by the act of a single public officer, to wit, the sheriff in his return, which cannot be averred against in that action; but the writer knows of no analogous principle on which the record of three justices of the peace, for instance, appointed as commissioners to organize a corporation, can be given in evidence to show that a third person is a member of the corporation. The recital in the record of a judgment that the defendant appeared in person or by attorney may be conclusive, for a judicial record imports absolute verity; but no rule is remembered by the writer which ascribes such a sanction to the records of ministerial official boards. The writer, therefore, ventures to think that any judicial decision which makes the original books of the commissioners appointed to organize a corporation, evidence to show that A. B. or C. D. became a stockholder therein, in an action to charge A. B. or C. D. as such stockholder, is a mere aberration, unless the persons sought to be charged are in some way connected with the record. Nevertheless it has been frequently held that the subscription books kept by such commissioners are presumptive evidence that the subscriptions therein contained are *genuine*, that is to say, made by the persons named or by persons duly authorized by them.[2] This presumption is a branch of the presumption that *public officers* act rightly until the contrary appears.[3]

[1] McKinney *v.* Guhman, 38 Mo App. 344; Griffith *v.* Gillum, 31 Mo. App. 33; Holladay *v.* Menefee, 30 Mo. App. 207.

[2] Rockville &c. Turnp. Road *v.* Van Ness, 2 Cranch C. C. (U. S.) 449; Lane *v.* Brainerd, 30 Conn. 565; Peake *v.* Wabash &c. R. Co., 18 Ill. 88; Marlborough &c. R. Co. *v.* Arnold, 9 Gray (Mass.), 159; Smith *v.* Natchez Steamboat Co., 1 How. (Miss.) 479.

[3] The presumption of right acting also extends to *unofficial persons:* Lenox *v.* Harrison, 88 Mo. 491. It has been held in Georgia that the original book, kept by the commissioners appointed by the charter of a railroad company for organizing the

Article IV. Other Evidence of Membership.

§ **1936. Effect of the Charter as Evidence.** — The *charter* of a corporation, issued by an officer of the State under a general law, is *prima facie* evidence that the persons named therein were members of the corporation at the commencement of its existence.[1] If the charter authorizes the corporation to take subscriptions for stock, without specifying in what manner, it is sufficient evidence, in a suit on such a subscription, no proof being offered to the contrary, that the corporation was authorized to enter into the contract with the defendant.[2] From the principle already discussed,[3] that the governing statute enters into and forms a part of the contract of subscription, it must follow that where this statute is in the form of a special act of the legislature, chartering the company, or in the form of articles of incorporation under a general law, in every case where the relation of stockholder is established the charter is evidence against him, provided it is relevant to the issues.[4]

§ **1937. Evidence of Assent of Subscriber.** — But a man cannot be made a member of a corporation without his consent; nor is it competent for the legislature to force a man into such a relation in a private corporation unless he assents thereto.[5] Therefore a special statute incorporating certain persons for

company, for the purpose of entering and recording therein their proceedings as such commissioners, together with the acts, resolutions, and proceedings of the commissioners, as recorded therein, is competent *evidence* in an action brought by such company for an installment alleged to be due on the subscription of a stockholder. Wood *v.* Coosa &c. R. Co., 32 Ga. 273.

[1] McHose *v.* Wheeler, 45 Pa. St. 41

[2] Wellersburg &c. Plank Road Co. *v.* Young, 12 Md. 476.

[3] *Ante*, §§ 1137, 1259.

[4] Scovill *v.* Thayer, 105 U. S. 143; s. c. 10 Myer Fed. Dec., § 163.

[5] *Ante*, §§ 66, *et seq.*; 1267, *et seq.*

purposes of private advantage or emolument, does not *bind* any person named therein, unless he consents thereto.[1] Accordingly, it has been held that where a partnership becomes incorporated, there must be some act or expression to signify their acceptance of the charter, in order to charge the several members as corporators.[2] So, where it did not appear that the defendants had in any manner signified their *refusal* to accept a charter incorporating a voluntary association, they were held not to be corporators; but it must be noted that they were not named in the charter.[3] So, an act of the legislature by which "the members of" several mutual fire insurance companies are made a new corporation, and which "shall not affect the legal rights of any person;" and is to take effect "when accepted by the members of said corporation," does not constitute a member of one of the old companies, who does not expressly assent to it, a member of the new corporation, although the act be duly accepted by a majority of the members of each of the old companies.[4] But where a corporation, organized under a general law, was subsequently *re-incorporated* under a special charter, it was held that, although the original subscription may have been made to the stock of the corporation formed under the general law, yet, if the subsequent act of incorporation was accepted, and, by consent and general understanding, the stock subscribed for in the first corporation was allowed to stand, and be treated as stock in the second corporation, its holders would be as effectually stockholders in this corporation as if they had become such by a new subscription, and their receipt of dividends would be evidence of an unequivocal character.[5]

§ 1938. **The Usual Evidence** is that the defendant signed the subscription paper, attended corporate meetings, and voted for directors.[6]

[1] Ellis *v.* Marshal, 2 Mass. 269; *s. c.* 3 Am. Dec. 49.

[2] Haslett *v.* Wotherspoon, 1 Strobh. Eq. (S. C.) 209, 254.

[3] Southern Steam Packet Co. *v.* Magrath, McMull. Eq. (S. C.) 93.

[4] Hamilton Mut. Ins. Co. *v.* Hobart, 2 Gray (Mass.), 543.

[5] Hammond *v.* Straus, 53 Md. 1.

[6] *Ante*, § 1877, *et seq.* When a defendant is sued as a stockholder in a railroad corporation for the sum remaining due upon an assessment upon his shares, after they are sold for non-payment of the assessment, it is competent and suf-

§ 1939. Evidence Which has been Held Sufficient.— That the person sought to be charged as a shareholder subscribed for a certain number of shares of the capital stock of the corporation; that his name was thereupon entered upon the records of the corporation as the owner of that number of shares; that the treasurer of the corporation had tendered to him his certificate therefor; and that he had been heard to state that he had taken such shares, — have been held evidence of his being a shareholder, in an action against him for assessments.[1] So, it has been held that a stockholder who pays to a bank the money for shares of its new stock, and takes a receipt on account of the subscription to new stock, and is entered in the stock book as a stockholder, and a stock certificate made out which he never calls for, is a stockholder as to such new shares.[2] Evidence that the party proceeded against as a stockholder agreed to subscribe for a given number of shares, and executed a power of attorney by which he acknowledged himself a stockholder of the company, and appointed certain persons his *proxies* to represent him in meetings of the stockholders, has been held abundant evidence to show that the party is a stockholder and to charge him as

ficient, for the purpose of showing him to be such stockholder, and liable for the assessment, to give *evidence* that he signed a subscription paper for shares, before the corporation was organized; that he attended the meeting of the stockholders for the organization of the corporation, and that he wrote and distributed votes, and himself voted for directors. Lexington &c. R. Co. *v.* Chandler, 13 Metc. (Mass.) 311.

[1] New Hampshire &c. R. Co. *v.* Johnson, 30 N. H. 390; *s. c.* 64 Am. Dec. 300. In this case, laying out of view the declaration of the alleged shareholder, which is only cumulative evidence, we have a complete contract, upon any theory. It contains the three elements of a proposition to the corporation by the intending shareholder to become a holder of a given number of its shares; of an acceptance of the proposition by the corporation, as evidenced by its act in entering his name as such on its records; and of a notification by the corporation to him of that fact, as shown by the tender of the certificate to him. Where stock of a national bank was *increased*, and the defendant subscribed for shares and paid for them, and received his certificate, he became a stockholder, and when the bank went into liquidation, he became liable, under U. S. Rev. Stat. § 5151, to pay an amount equal to the stock so held, for debts of the bank. Aspinwall *v.* Butler, 133 U. S. 595; *s. c.* 33 L. ed. 779; 10 Sup. Ct. Rep. 417.

[2] Pacific Nat. Bank *v.* Eaton, 141 U. S. 227; *s. c.* 35 L. ed. 702; 10 Rail. & Corp. L. J. 132; 11 Sup. Ct. Rep. 984; Thayer *v.* Butler 141 U. S. 234; *s. c.* 35 L. ed. 711; 11 Sup. Ct. Rep. 987.

such.[1] Evidence that a certain person was one of the incorporators of a bank, and kept an open account at it for several years after its organization, and that he had a receipt from its officers reciting that he had paid in 10 per cent. of the subscription, and would be entitled to a certain number of shares upon the payment of the "balance due," was held sufficient to show him to be a stockholder, where his testimony that the money paid was a loan to one of the officers of the bank was disputed by the latter.[2]

§ **1940. Declarations and Admissions.** —If a party admits himself to be a subscriber, and, on the faith of such admission, others have acted for his benefit, he will be estopped from subsequently denying that he did in fact subscribe.[3] But where the defense is that the agreed number of shares had not been *bona fide* subscribed so as to make the subscription binding, the declarations of *another subscriber* that he did not intend to pay for his subscription, are not admissible in evidence on behalf of the defendant to show fraud on the part of the corporation.[4] Another court has held that the declarations of a *commissioner* authorized by an act of the legislature to receive subscriptions to the capital stock of a private corporation, that a particular individual subscribed for a certain number of shares and paid the first installment thereon, are neither against his pecuniary interest nor made in the ordinary course of his duty. They are, therefore, not admissible in evidence to prove the fact of subscription, in an action brought by the corporation, after the death of the commissioner, against the alleged subscriber, to compel payment of the subscription.[5]

§ **1941. Sufficient Evidence of Acceptance of Proposal by Corporation.**— Where, in an action on a stock subscription, it appeared that the defendant subscribed to the capital of the cor-

[1] Vanderwerken *v.* Glenn, 85 Va. 914; *s. c.* 6 S. E. Rep. 806; 17 Wash. L. Rep. 86.

[2] Ross *v.* Bank of Gold Hill, 20 Nev. 191; *s. c.* 18 Pac. Rep. 243.

[3] Graff *v.* Pittsburgh &c. R. Co., 31 Pa. St. 489.

[4] Hayden *v.* Atlanta Cotton Factory, 61 Ga. 233.

[5] Western &c. R. Co. *v.* Manro, 32 Md. 280.

poration, which had been created for building a seminary, but, after the seminary was built refused to pay his subscription,— it was held that the delivery of the subscription, the demand of payment, and the subsequent suit to recover the same, were sufficient evidence of acceptance of the subscription by the corporation.[1]

§ **1942. When Certified Copy of Subscription is not Evidence.** — Where there is *no law* authorizing a paper containing the subscription to the capital stock of a corporation to be filed in the office of the Secretary of State, a copy thereof, certified under the seal of the Secretary of State, is not admissible as *prima facie* evidence, in a suit by the corporation to charge the defendant as a stockholder.[2]

§ **1943. Certificate of the Secretary.** — Charters have been granted which contain the provision that the certificate of the secretary of the company shall be evidence of any act or order of the directors. This, it has been held, requires a certificate *in totidem verbis*, and that the secretary cannot certify that a "sufficient" call was made; and his certificate that he "published notice" of the calls is not admissible in evidence.[3]

[1] Richmondville Seminary *v.* McDonald, 34 N. Y. 379.

[2] Troy &c. R. Co. *v.* Kerr, 17 Barb. (N. Y.) 581. Compare Bouchaud *v.* Dias, 3 Denio (N. Y.), 238; Dick *v.* Balch, 8 Pet. (U. S.) 33; Jackson *v.* Leggett, 7 Wend. (N. Y.) 377.

[3] Tomlin *v.* Tonica &c R. Co., 23 Ill. 429. Under section 4 of the act (Mo. Local Laws 1845, 15), which exempts members of the corporation of fire wardens from jury service, and declares that the certificate of the secretary "certifying to their membership shall be competent evidence of the fact," and that the certificate "shall be granted only to active members,"—the exhibition of such certificate is proof only of the mere fact of membership, and not that the bearer is an active and faithful member of the corporation; and such a certificate will not *exempt him from jury duty*. State *v.* Pimm, 50 Mo. 87.

Article V. Other Points of Evidence.

§ **1946. Genuineness of the Other Signatures.** — It is not essential to the company's right of action against a subscriber to show that the *other signatures* to the contract are genuine. The reason is that his promise is *several* and is not conditioned, by the terms of the contract, upon the fact *of their subscribing*.[1] But, of course, if *fictitious names* have been put down for the fraudulent purpose of inducing him to subscribe, that is matter of defense which he may plead and prove.[2]

§ **1947. Depositors in Savings Banks.** — Whether depositors in savings fund societies are members of the corporation depends upon the charter or governing statute. In some schemes, as in Pennsylvania, they are members, and the directors are their trustees in such a sense as to be personally liable to them for breaches of their trust.[3] It has been held in Connecticut that they are not, as such, stockholders or members of the savings society;[4] but as the question in each case depends upon the law of the society, no definite *rule* can be stated. Schemes of organization have often been met with where the *stockholders* themselves are not members of the society, — as where a joint-stock was created for the further security of the members.[5]

[1] Richmondville Seminary *v.* McDonald, 34 N. Y. 379.

[2] *Ante*, § 1430.

[3] *Post*, § 4153.

[4] Savings Bank *v.* New London, 20 Conn. 111.

[5] This was the case where a statute of Pennsylvania incorporated certain persons named, and others thereafter becoming members, to receive deposits of money and pay interest to the depositors, and directed that, for the security of the depositors, a certain capital should be raised, to be divided into transferable shares. The statute also provided for yearly meetings of the members, and for the election of directors from among the members, and authorized the directors to provide for the admission of members, and directed them to appoint from among the members, a committee of

§ 1948. Subscription by Agent or Attorney.— A party may, of course, become bound as a shareholder where another person subscribes his name for the shares at his request.[1] In such a case the principal, and not the agent becomes liable as a stockholder.[2] Opposing decisions are found on the question whether, in case the person who assumes to subscribe for shares for another, acts without authority from that other, he thereby renders himself a shareholder. In Vermont it is held that he does; that he thereby becomes the equitable owner of the shares; that a transfer to him from the person in whose name he has assumed to make the subscription is not necessary; but that it is sufficient that the stock is carried to his account on the stock register.[3] In Massachusetts it has been held that the unauthorized agent does not thereby make himself a member of the corporation.[4] But it would seem, on principle, that the person thus signing without authority the name of another might be held personally to the contract, on the theory of a breach of warranty of agency. That he is liable in some form for the wrong done is obvious; and while it has been held that the corporation cannot maintain an action

examination, and likewise to make a dividend of profits, and pay the same to the stockholders or their representatives. Here it was held, that stockholders, as such, were not members of the corporation, and of course that the assignee of a stockholder did not, by the assignment, become a member; and that the original members continued to be members, although they never had any stock, or had disposed of it. Philadelphia Savings Institution, Case of, 1 Whart. (Pa.) 461; *s. c.* 30 Am. Dec. 226.

[1] It has been held that a provision in the charter of a bank, "that it shall not be lawful for any person to subscribe for shares in the name of other persons," does not exclude a *bona fide* subscription by an attorney, in the name of his principal. But the commissioners to take the subscription may, if they doubt the good faith of the subscription, require further evidence than the mere production of a power of attorney, to remove their doubts. State *v.* Lehre, 7 Rich. L. (S. C.) 234.

[2] Thus, where, at the request of W., J. subscribed for certain shares for him thus,—"J., for W.," and W. paid the installment due thereon, but the stock was never transferred to W.'s name on the books, W. was the legal owner and a stockholder, under a statute making stockholders personally liable for the debts of the corporation. Burr *v.* Wilcox, 22 N. Y. 551, 557; *s. c.* 6 Bosw. (N. Y.) 198. A New York court holds that there is nothing in the statute of the Province of Quebec under which one, at whose request another has taken shares of corporate stock in his own name, becomes himself liable as a stockholder. Molson's Bank *v.* Boardman, 47 Hun (N. Y.), 135.

[3] State *v.* Smith, 48 Vt. 266.

[4] Salem Mill-Dam Corp. *v.* Ropes, 9 Pick. (Mass.) 187; *s. c.* 19 Am. Dec. 363.

against him for assessments, it has been *said* that it can maintain a special action on the case against him for the wrong done.[1]

§ 1949. Interpretation of Particular Subscription Papers.— A subscription to the capital stock of an existent corporation is a *contract* between the subscriber and the corporation;[2] and, as already seen, a subscription to the capital stock of a projected company becomes a contract as soon as it becomes organized.[3] But such a paper must have the essential elements of a contract, in so far as to be, in express terms or by reasonable implication,[4] a direct promise to take shares. Such was the view of the Supreme Court of Oregon in a case already set out.[5]

§ 1950. Burden of Proof. — If the subscription is made upon a valid *condition precedent*[6] the burden is upon the corporation to show compliance with the condition on its part, or a waiver of compliance by the defendant.[7] But if the defense of the subscriber is *payment*, or something done which is the equivalent of payment or satisfaction, then, upon a well understood rule,[8] the burden is on the defendant.[9]

§ 1951. Value of the Stock. —In a suit by a corporation to collect capital stock subscribed, evidence of the value of that or any other stock is irrelevant.[10]

§ 1952. Other Points of Evidence in Such Actions. —In a suit against a corporation under the old rule excluding from the witness stand parties in interest, it was held that a *stockholder* was a *competent* witness *in behalf of the corporation*.[11] - - - - It is not necessary, in such an action, to prove that the *directors* were duly elected. The rule here obtains which supports acts of *de facto* public officers when collaterally called in question.[12]

1 *Ibid.*

2 Melvin *v.* Hoitt, 52 N. H. 61.

3 *Ante*, § 1170.

4 *Ante*, § 1138.

5 *Ante*, § 1195.

6 *Ante*, § 1332, *et seq.*

7 Central Turnpike Corp. *v.* Valentine, 10 Pick. (Mass.) 142. Compare Salem Mill-Dam Corp. *v.* Ropes, 6 Pick. (Mass.) 23.

8 1 Greenl. Ev., § 74.

9 Denny *v.* North Western &c. University, 16 Ind. 220.

10 South Georgia &c. R. Co. *v.* Ayres, 56 Ga. 230.

11 Barclay *v.* Globe Mutual Ins. Co., 26 Mo. 490; Bredow *v.* Mutual Savings Assn., 28 Mo. 181. But *contra*, see Crozer *v.* Leland 4 Whart. (Pa.) 12.

12 Rockville &c. Turnp. Road. *v.* Van Ness, 2 Cranch C. C. (U. S.) 449.

CHAPTER XXXI.

DEFENSES TO ACTIONS FOR ASSESSMENTS.

§ **1955. Scope of This Chapter.** — It is proposed in this chapter to consider certain defenses to actions for assessments which have been frequently attempted, and sometimes with success, where the action is brought by the corporation itself. Cases where the action is brought, after the insolvency of the corporation, by creditors or by their representatives, have been, so far as practicable, reserved for consideration in future chapters.

§ 1956. Subscription Feigned and Fraudulent.— And first as to matters affecting the contract of subscription. It is no defense to such an action that the subscription was feigned or fraudulent, and that the company was a party to the fraud;[1] since the defendant will not be heard to allege his own turpitude as a reason for escaping the liability which he has assumed. On this ground, the fact that the stockholders, by an agreement among themselves, issue to themselves their stock certificates as "*paid-up shares*"[2] furnishes no ground upon which one of them who is a party to the agreement, can have his subscription set aside.[3] But of course, this rule has no application to the case where the subscriber, being himself innocent, has been induced to subscribe by the fraud of the corporation or of those acting for it.[4]

§ 1957. No Contract: Abandonment of Subscription Paper.— While parol evidence is not, in general, admissible to contradict or vary the terms of a written contract,[5] yet it has been held competent to show by such evidence that the subscription list, signed by the defendant, was *abandoned*, and a *new* one opened, and made the basis of the organization of the company.[6]

§ 1958. Illegality of the Subscription or Allotment. — The validity of the contract of subscription has often been attacked in these actions — generally without success — on the ground of irregularity or illegality on the part of the commissioners, promoters, or agents having the matter in charge. The following defenses, which fall under this head, have been held unavailing: The failure to give *notice* of the time and place of receiving the subscriptions, since the object of the statutory provision for such notice is merely designed to prevent a monopoly of the stock, and the want of notice is therefore no defense to one who

[1] Graff *v*. Pittsburgh &c. R. Co., 31 Pa. St. 489; *ante*, § 1399.

[2] As to which see *ante*, § 1578, *et seq*.

[3] Goff *v*. Hawkeye Pump & Windmill Co., 62 Iowa, 691; Wurtzberger *v*. Anniston Rolling Mills, 94 Ala. 640; *s. c*. 10 South Rep. 129. See also Clayton *v*. Ore Knob Co., 109 N. C. 385; *s. c*. 14 S. E. Rep. 36.

[4] *Ante*, § 1361.

[5] *Ante*, § 1311.

[6] Southern Hotel Co. *v*. Newman, 30 Mo. 118.

does subscribe;[1] that the subscription books were opened upon a *notice* signed not by all but by a majority only of the original corporators;[2] that some of the subscriptions necessary to make up the requisite amount were improperly made, provided they were accepted *bona fide* and acted upon by the corporation;[3] that the sum subscribed *exceeded* the amount intended to be raised; but in such a case the subscriptions of all the subscribers should be paid *pro rata;*[4] the failure of the agent who received the subscription to return the subscription paper to the home office of the corporation, since this was not necessary to complete the contract of subscription;[5] that the subscription was made before the organization of the company took place;[6] that the *stock* had never been received by the commissioners, having been delivered to them in escrow merely, inasmuch as that allegation was contradicted and disproved by the record,— that is, it was recognized by the plaintiff corporation as valid stock;[7] that the formula at the head of the contract of subscription was not precisely the same as that recited in the act of incorporation in respect of the name or designation of the corporation itself, the

[1] Hagerstown Turnpike Co. *v.* Creeger, 5 Har. & J. (Md.) 122; *s. c.* 9 Am. Dec. 495. See also Union Turnpike Co. *v.* Jenkins, 1 Caines (N. Y.), 381, 389. In such a case it was held an error to refuse to instruct the jury that they might presume that the notice above described was given according to the directions of the law; the court saying: "Where a corporation has gone into operation and rights have been acquired under it, every presumption should be made in favor of the legality of its existeuce." Hagerstown Turnp. Co. *v.* Creeger, 5 Har. & J. (Md.) 122; *s. c.* 9 Am. Dec. 495.

[2] Penobscot R. Co. *v.* White, 41 Me. 512; *s. c.* 66 Am. Dec. 257.

[3] Bailey *v.* Calvert &c. Education Soc., 47 Md. 117. *Ante*, §§ 1724, 1725, 1726.

[4] State Treasurer *v.* Cross, 9 Vt. 289; *s. c.* 31 Am. Dec. 626; *ante*, § 1721. It is quite the reverse where the requisite capital is not subscribed for. *Ante*, § 1724.

[5] Pickering *v.* Templeton, 2 Mo. App. 424, 429. "The contract of subscription," said the court, "was complete when it was received by the agent of the company. The subsequent casual or intentional destruction of the list, or the bad faith of Carstarphen to his principals, could have no effect to liberate the stockholders from their obligations to the creditors of the corporation."

[6] Stanton *v.* Wilson, 2 Hill (N. Y.), 153. See *ante*, § 1161, *et seq.*

[7] Wight *v.* Shelby R. Co., 16 B. Monr. (Ky.) 4; *s. c.* 63 Am. Dec. 523. But what the pleader meant by the idiocy of the stock not having been received by the commissioners, it would be hard to imagine. If he meant that the certificates of shares had never been received by the commissioners to be delivered to him, he should have stated it in that way.

variance not being material, and such as to amount to a failure of identity.[1]

§ 1959. That the Shares Were not Allotted by Numbers.— Where a person has subscribed to the capital stock of a corporation, and an action is brought against him for an assessment, it will be no defense on his part that the shares were not allotted to him by numbers; but that notwithstanding this, the company proceeded to forfeit his shares, to sell them, and to bring the present action against him for the residue. The reason is that, the shares being equal in amount, no confusion could arise from the failure to allot the shares to the subscriber by particular numbers.[2] Of course, the rule is different where the governing statute prescribes that the name of the shareholders shall be entered upon the register of the company, "together with the number of shares to which such shareholder shall be entitled, distinguishing each share by its number;" and on this ground certain English cases are to be distinguished.[3]

§ 1960. That Notes were Received from the Subscriber instead of Money.— Nor is it a good defense to an action by the corporation on a *promissory note* given by a subscriber in settlement of his subscription, that the corporation improperly received the note in payment of the stock, instead of requiring the defendant to pay the money.[4]

[1] Hagerstown Turnp. Co. *v.* Creeger, 5 Har. & J. (Md.) 122; *s. c.* 9 Am. Dec. 495. So of a *subscription book:* Ober *v.* Baltimore &c. R. Co., 41 Md. 583.

[2] European &c. R. Co. *v.* McLeod, 3 Pugsley (N. B.), 3, 32, 40.

[3] Newry &c. R. Co. *v.* Edmunds, 2 Exch. 118, 123; Wolverhampton Water Works *v.* Hawksford, 7 C. B. (N. S.) 795, 809. In the latter case it was said by Erle, C. J., that "no share had been numbered and no specific shares had been appropriated;" but the real ground of the decision seems to have been that the defendant's name was not on any register of shareholders such as the company was required by the act to keep. At least, this was the understanding of the case by a majority of the Supreme Court of New Brunswick. European &c. R. Co. *v.* McLeod, 3 Pugsley (N. B.), 3, 33.

[4] Finnell *v.* Sandford, 17 B. Mon. (Ky.) 748; Home Stock Ins. Co. *v.* Sherwood, 72 Mo. 461; *ante,* §1220. It is not a good defense, within Sec. 9 of the Illinois act of 1845, to an action by a corporation on notes given for a subscription to the stock, that the notes were *stock notes.* Ryan *v.* Vanlandingham, 25 Ill. 128. See *ante,* § 1657, *et seq.*

§ 1961. Release by Directors of Other Shareholders. — Nor is it any defense to such an action that the directors, without the consent of the other stockholders, released certain of the subscribers to the company's stock from liability therefor; for such a release, if made, is void, and the stockholder whom the directors have attempted to release remains bound to make good his subscription.[1] A similar view of the question was taken in a case which arose between the transferor and transferee of certain corporate shares. F. had agreed to sell certain shares to H. The corporation, by allowing those who paid but $30 per share an equal participation in the profits with those who had paid $100, had lessened the market value of the stock. It was held that if this act was legal, H. was bound to know what the railroad company might do, and this would therefore form one of the contingencies of his purchase; but if the act was unlawful, H. might resist it when he became a stockholder in the legal way, and it would form no defense for H. in a suit for non-performance of the contract.[2]

§ 1962. Non-Delivery of Stock Certificate. — As already suggested,[3] the subscriber cannot set up the failure or refusal of the corporation to deliver to him his stock certificate as a defense against its action for calls.[4] No tender of a certificate of stock is necessary as a condition precedent to the right of the corporation to maintain an action for assessments against the subscriber. The reason has been said to be that the certificate does not constitute his stock, but is only the evidence of it, or his muniment of title, and that it is the registry of his name upon the stock book of the company opposite the number of his shares which in fact gives him his title to his stock.[5] Accordingly, a complaint or declaration in such an action is not bad because it does

[1] Chouteau Ins. Co. *v.* Floyd, 74 Mo. 286, 291; Dorman *v.* Jacksonville &c. Plank Road Co., 7 Fla. 265. Compare Gill *v.* Balis, 72 Mo. 432; Upton *v.* Tribilock, 91 U. S. 45; *ante*, § 1545.

[2] Faulkner *v.* Hebard, 26 Vt. 452.

[3] *Ante*, § 1140.

[4] Smith *v.* Gower, 2 Duv. (Ky.) 17; South Georgia &c. R. Co. *v.* Ayres, 56 Ga. 230; Dallas Cotton &c. Mills *v.* Clancey (Tex. App.), 15 S. W. Rep. 194. See Hawley *v.* Upton, 102 U. S. 314; Farrar *v.* Walker, 3 Dill. (U. S.) 506.

[5] New Albany &c. R. Co. *v.* McCormick, 10 Ind. 499; *s. c.* 71 Am. Dec. 337.

not aver that certificates of stock were tendered to the defendant before the action was brought.[1] Especially is it true that the mere failure to issue certificates to the subscriber, in respect of the shares for which he has subscribed, can not be set up as a defense, where he has not demanded them and the corporation has not refused them, and this for the reason above stated.[2] Accordingly, a paragraph of an answer setting up that the corporation has made no tender of a certificate of his stock to the defendant, is bad.[3]

§ 1963. Guaranty that Company will Pay Interest on Stock. — A guaranty in the contract of subscription that the corporation will pay interest on the stock, "as soon as paid," constitutes no defense to an action against the stockholder for an assessment, although the company in the meantime has suspended operations. The reason is that the obligation of the company does not arise by the terms of the contract, and consequently is not broken until all the assessments which may be made upon the subscription have been paid.[4]

§ 1964. Legality of the Assessment. — The defendant may, of course, challenge the legality of the assessment.[5] He may show that the order for it was made by *less than a majority* of the directors, and is therefore void; and subsequent action by the whole board under this order will not amount to a ratification.[6] Where the governing statute requires that the share-

[1] Miller *v.* Wild Cat Gravel Road Co., 52 Ind. 58.

[2] Chester Glass Co. *v.* Dewey, 16 Mass. 94; *s. c.* 8 Am. Dec. 128.

[3] Vawter *v.* Ohio &c. R. Co., 14 Ind. 175; Heaston *v.* Cincinnati &c. R. Co., 16 Ind. 275; *s. c.* 79 Am. Dec. 430; Drover *v.* Evans, 59 Ind. 458; Beaver *v.* Hartsville University, 34 Ind. 248; Hartsville University *v.* Hamilton, 34 Ind. 509; Slipher *v.* Earhart, 83 Ind. 178. That the company is at most bound to make a conditional tender, see Hardy *v.* Merriweather, 14 Ind. 206.

[4] Miller *v.* Pittsburgh &c. R. Co., 40 Pa. St. 237; *s. c.* 80 Am. Dec. 570. In this case and in the subsequent case of Pittsburgh &c. R. Co. *v.* Allegheny County, 63 Pa. St. 136, the practice of paying interest on stock is denounced, and in the latter case it is held that the corporation cannot, without statutory authority, bind itself for such interest.

[5] *Ante,* § 1702. Lancaster Starch Co. *v.* Moore, 62 N. H. 671.

[6] Price *v.* Grand Rapids &c. R. Co., 13 Ind. 58; Cowley *v.* Grand Rapids &c. R. Co., *Id.* 61; Hamilton *v.* Grand apids &c. R. Co., *Id.* 347.

holders shall be assessed equally in respect of their subscriptions, if an *equal assessment* has not been made, this fact is a good defense on the part of any shareholder when sued by the company to recover an assessment. It was so held under such a statute in respect of an assessment of the shares of capital stock of the New Brunswick Railway Company, where the assessment was made upon the stock, exclusive of the sum of $250,000, stock which had been subscribed in the United States.[1]

§ **1965. Prior Forfeiture of the Shares.** — The defendant cannot plead that, by reason of his default respecting another installment, he had forfeited to the corporation all the shares subscribed by him, and that the amount thus forfeited was equal to the amount claimed in this suit.[2] But as already seen,[3] a valid forfeiture of shares, and hence one not fraudulent or collusive,[4] dissolves the connection between the shareholder and the company, and therefore creditors of the company cannot, in the event of its becoming insolvent, charge him as a shareholder with the amount remaining unpaid on his shares.[5]

§ **1966. Transfers to Escape Liability.** — Within the limits hereafter discussed,[6] if a subscriber to stock of a corporation transfer it without the assent of the corporation, for the purpose of escaping liability on his subscription, the transfer will be no defense to him in an action for the amount due on his subscription.[7] But the corporation — the rights of the creditors not being involved — may *affirm* such a transfer and proceed against the transferee; and it will be no defense for the transferee to show that the transfer was made *without any consideration.*[8]

§ **1967. That the Directors Made an Assignment of the Right of Action in Fraud of the Corporation.** — We have seen[9]

[1] European &c. R. Co. *v.* McLeod, 3 Pugsley, N. B., 3.

[2] Herkimer &c. Co. *v.* Small, 2 Hill (N. Y.), 127.

[3] *Ante*, § 1792, *et seq.*

[4] *Ante*, § 1792.

[5] Allen *v.* Montgomery R. Co., 11 Ala. 437.

[6] *Post*, §§ 2303–2305, 3255, *et seq.*

[7] Everhart *v.* West Chester &c. R. Co., 28 Pa. St. 339.

[8] Hall *v.* United States Ins. Co., 5 Gill (Md.), 484.

[9] *Ante*, § 1818.

that a corporation has the power to make an assignment of its stock subscription, and this is even more clear where the indebtedness of the subscriber for his shares has been liquidated by his *notes*.[1] In such a case, the assignment being valid, the assignee will, under any circumstances, succeed to the rights of the corporation, his assignor. When, therefore, a corporation, by its directors, assigned one of its stock notes to certain of its directors, as security for advances, who afterwards brought suit upon it in the name of the corporation for their own benefit; and the corporation was at that time, and had ever since remained insolvent; and the defendant, at the time of the assignment and of the bringing of the suit, was a stockholder,—it was held that he could not avail himself, by way of defense to the suit, of the fact that the note had been so assigned, even if such assignment could be regarded as a fraud upon the corporation.[2]

§ **1968. Violations of Charter.**— It is no defense to such an action that the directors of the corporation have violated the charter;[3] as by issuing shares to the defendant in contravention of its provisions;[4] that they have caused a portion of the roadway of the plank road which the corporation was organized to build to be constructed of gravel instead of plank;[5] or that the corporation has not managed its business in the places required by law.[6] Nor can the stockholder in such an action set up that which, in a contract proceeding by the State, would work a *forfeiture of the charter;* for such matters cannot be inquired into collaterally, but can only be challenged by the State.[7] But of course it is competent for the legislature to make the individual subscriber a representative of the State, just as the plaintiff is, to some extent, in an action *qui tam*. It can enact that a particular violation of the charter or governing statute shall take away a given right of action by the corporation, in which case

[1] *Ante*, § 1660.

[2] Protection Ins. Co. *v.* Ward, 28 Conn. 409.

[3] Hannibal &c. Plank Road Co. *v.* Menefee, 25 Mo. 547.

[4] Canal Bank *v.* Holland, 5 La. An. 363.

[5] Hannibal &c. Plank Road Co. *v.* Menefee; *supra*.

[6] Courtright *v.* Deeds, 37 Iowa, 503.

[7] Connecticut &c. Co. *v.* Bailey, 24 Vt. 465; *s. c.* 58 Am. Dec. 181; Smith *v.* Tallahassee Branch &c., 30 Ala. 650; Hanover &c. R. Co. *v.* Grubb, 82 Pa. St. 36.

the violation of the charter or statute is of course pleadable as a defense to the given action, and must be tried collaterally. Thus, a statute of Missouri, enacted to prevent *illegal banking*, prohibited the passing of bank-notes of a less denomination than five dollars, and it was held that this violation of its charter might be pleaded in bar of any suit instituted by it, although the result would be to work a forfeiture of its charter *pro tanto*.[1] Under that statute, a stockholder sued for his subscription might plead a violation of the act by the corporation in bar of the suit.[2] Referring to this decision, the Supreme Court of Missouri, in a subsequent case, say: "One exception to the rule which prohibits collateral inquiry by a private citizen into the supposed illegal acts of a corporation, is where express legislative permission is granted therefor."[3]

§ 1969. Illustration: Failure to Expend the Amount Required by its Charter. — Where the governing statute requires a railroad company to expend in the construction of its road a certain per cent. of its capital, or a given amount of money, within a given time, its failure to do so cannot be proved collaterally by a stockholder, as a defense to such an action.[4] Thus, where the charter provided that the work should be prosecuted in sections, and that a majority in amount of the subscribers in each parish should have the right to say on what section of the road their subscriptions should be used, — a violation of this provision by the corporation was no defense.[5] So, where the charter required the commencement of the construction of the road, and the expenditure of $20,000 thereon, within five years in one case, and three years in another, in default of which the charter should be void, and also saved from forfeiture so much of the road as should be built within the time limited, forfeiting only the unfinished portion, — it was held that a stockholder could not set up as a defense, in an action upon an assessment, that the corporation had not shown a compliance with this provision of the charter, by introducing evidence showing that the sum of $20,000 had not been expended in the construction of its road, as thus required. The reason was that "it would

[1] Christian University *v.* Jordan, 29 Mo. 68.

[2] North Missouri R. Co. *v.* Winkler, 33 Mo. 354.

[3] Martindale *v.* Kansas City &c. R. Co., 60 Mo. 510.

[4] Thornburgh *v.* Newcastle &c. R. Co., 14 Ind. 499; Connecticut &c. R. Co. *v.* Bailey, 24 Vt. 465; *s. c.* 58 Am. Dec. 181, 185.

[5] Vicksburg &c. R. Co. *v.* McKean, 12 La. An. 638

be exceedingly inconsistent to say that the corporation must expend that sum in the construction of their road, and at the same time deny them the right and power of collecting their subscriptions for that purpose. That could never have been the intention of the legislature. The charter, in its duration, is perpetual, and this provision of the act is a reservation of the right on the part of the State, to cause its charter to be vacated, if the corporation neglects or refuses to exercise its corporate franchise within that period. But this cause of forfeiture may be *waived* by the State; an illustration of which is found in this charter; a forfeiture accrued under the act of 1835, but was waived by the act of 1843, on this very subject. It is a matter exclusively between the corporation and the State granting the charter. If they waive the forfeiture, no other person can take advantage of it. If they insist upon the forfeiture, as a general rule, the corporation has still its legal existence, until a judgment of ouster is had, under judicial proceedings. 'It can not be tried or put in issue, collaterally or incidentally, in any other mode than by direct proceedings for that purpose against the corporation.' Until, therefore, this charter is vacated by such proceedings, the corporation has its legal existence, and may enforce payment of its assessments."[1]

§ 1970. Non-Feasance, Malfeasance or Mismanagement by the Directors. — Stockholders are only bound by the acts of the directors within the scope of their authority. Unauthorized acts may be restrained, or, if performed, rescinded by a court of equity. And, although a court of equity will not relieve a stockholder in the mere case of unwise management by their directors, because the courts cannot enter upon general superintendence of corporate business, yet the stockholders are left in no worse position than men often are who associate themselves in partnership with others for the purposes of business enterprises. The directors are their own agents, and they can generally find relief in the election of new directors. At all events the judicial courts cannot undertake to superintend the affairs of every corporation in the country.[2] It follows that the fact that the directors have

[1] Connecticut &c. R. Co. *v.* Bailey, 24 Vt. 465, 475; *s. c.* 58 Am. Dec. 181, 187. See also People *v.* Manhattan Co., 9 Wend. (N. Y.), 351. That a court will not, in a collateral way, decide a question of *misuser* of charter, see Silver Lake Bank *v.* North, 4 Johns. Ch. (N. Y.) 370. That the raising of a sum named is not a condition precedent to making a call, see Waterford &c. R. Co. *v.* Dalbiac, 6 Exch. 443; *s. c.* 4 Eng. L. & Eq. 455.

[2] *Post*, § 4471, *et seq.*

been guilty of reckless, extravagant, or unwise management of the affairs of a corporation will not release a stockholder from the obligation of his subscription.[1] The same principle holds good where the misfeasance of the directors has been such as might, in a proceeding by the State, work a *forfeiture of the franchises* of the corporation.[2] A shareholder is not allowed to shirk his obligation and thereby diminish the fund intended for the security of the public, in this way.[3]

§ **1971. Illustrations.**— Thus, it is no defense that the directors have invested the corporate funds in the purchase of the stock of another company, and of a large and expensive building in which to do business;[4] or that they received the private *notes* of the shareholders in payment of their subscriptions, instead of collecting them in cash and investing the money as prescribed by the charter.[5] So, where a corporation was organized for the purpose of building levees for the improvement of overflowed lands, and empowered to levy an assessment of a certain sum per acre upon all lands within the district to be reclaimed, it was held no defense to an action for such an assessment that the work had not been properly done. This statement of doctrine assumes that the persons so assessed are members of the corporation, and have a voice in the election of its directors and in the management of its affairs, just as shareholders in a joint-stock company have.[6] Nor is it any defense to such an action that, at the time when the assessment sued for was made, there were no unpaid debts of the corporation; that certain officers and directors of the corporation had, for their private gain, prior to that time, settled and compromised said debts, and paid all claims against the corporation, without the knowledge or consent of the stockholders.[7] The reason of this is obvious. If the directors pay the debts at a discount, the corporation is entitled to the profit made by the transaction; and that is a question between the corporation and the directors. But whether the directors pay them at a discount or not, they are entitled to be re-imbursed for the advances thus made by them, and to stand as creditors of the corporation for this

[1] Chetlain *v.* Republic Ins. Co., 86 Ill. 220; Merrill *v.* Reaver, 50 Iowa, 404; Southern Life &c. Co. *v.* Lanier, 5 Fla. 110.

[2] Smith *v.* Tallahassee Branch &c., 30 Ala. 650.

[3] Southern Life Ins. Co. *v.* Lanier, 5 Fla. 110; *s. c.* 58 Am. Dec. 448.

[4] Chetlain *v.* Republic Life Ins. Co., 86 Ill. 220.

[5] Little *v.* O'Brien, 9 Mass. 423.

[6] Columbia Bottom Levee Co. *v.* Meier, 39 Mo. 53.

[7] Chouteau Ins. Co. *v.* Floyd, 74 Mo. 286, 291.

amount,[1] and to use the corporate machinery for enforcing contribution from the shareholders. Upon this subject the following judicious observations were made by Henry, J.: "Public policy, we think, demands that the conduct of directors and other officers of a corporation which has not in its treasury money to pay its liabilities, in satisfying such demands out of their private means, should be sanctioned, and not treated as bad faith towards the stockholders, releasing them from their liability to pay for their stock. Especially should this be so, since they are not permitted to make any profit for themselves by such conduct. It is a duty of the directors to provide for the payment of the liabilities of the corporation, and they are entitled to commendation rather than deserving censure, if of their own means, they pay its debts, when its treasury is depleted.[2]

§ 1972. **Irregularities in Corporate Action.** — For stronger reasons the fact that *irregularities* have taken place in the manner in which the *managers*, or the *majority of the stockholders*, have exercised the powers of the corporation, affords no defense to such an action, — such as irregularities in the adoption of *by-laws*, or in the *election of officers*, where all the stockholders and officers thereof recognize and treat such by-laws and such election as legal and valid; [3] or the fact that, after the subscription was made, a by-law was adopted requiring the payment of the first installment before the subscriber would be entilted to vote on corporation matters.[4] Nor can the defendant give evidence that there was not a sufficient number of the directors of the bank present, at the time of making a certain order, competent to transfer business of that description; and that funds had been withdrawn from the bank under that order, when the charter required a greater number of directors, whereby he, as a

Lingle v. Nat. Ins. Co., 45 Mo. 109.

[2] Chouteau Insurance Company v. Floyd, 74 Mo. 286, 291. A case in Louisiana, apparently not following the same lines of legal thought, is to the effect that where a corporation, not prohibited from dealing on credit, sues a stockholder for a contribution to pay a note it has issued, the defendant, who pleads that such issue was not authorized, must allege and prove that the note was given for purposes unsanctioned by, and prejudicial to the shareholders, to the holder's knowledge when he took it, or that he took it after maturity. Brown v. Union Ins. Co., 3 La. An. 177.

[3] Ginrich v. Patrons' Mill Co., 21 Kan. 61.

[4] Chandler v. Northern Cross R. Co., 18 Ill. 190, 193.

stockholder, had been *deprived of a dividend* on his stock.[1] In like manner, it is no defense to an action on a stock subscription by a company organized to carry on the business contemplated in the subscription, and engaged in that business only, that it might, under the act of incorporation, have carried on *other business*.[2] So, a subscriber to shares in a New Jersey banking company, who has received a certificate, cannot claim exemption from a suit prosecuted by its receiver on the ground that the associates never chose a board of directors, or obtained deposits, but only issued circulating notes and accepted bills of exchange.[3]

§ 1973. Irregularity or Illegality in the Election of Directors.— Nor will the fact that the directors have been irregularly or even illegally elected, be any defense to such an action,[4] — as that they have been elected without sufficient *notice*;[5] or that they have been elected at an election which took place *outside the State*.[6] The principle which validates the action of *de facto* officers and excludes collateral inquiry into their right to hold office applies in such cases.

§ 1974. Non-compliance with Charter Provisions as to Time of Commencing Operations. — It should seem that the same principle applies where the charter requires the corporation to enter upon the construction of its works, *e. g.*, a railroad, within a given length of time, and it fails to do so, so that this will not release the subscribers to its shares. On principle, this is a matter which rests exclusively between the State and the corporation. It is a ground of forfeiture of the charter of the corporation, which the State may enforce or waive; and if the State has not seen fit to enforce it a subscriber can not set it up

[1] Whittington *v.* Farmers' Bank, 5 Har. & J. (Md.) 489.

[2] Haskell *v.* Worthington, 94 Mo. 560.

[3] Dayton *v.* Borst, 7 Bosw. (N. Y.) 115, 121.

[4] Johnson *v.* Crawfordsville &c. R. Co., 11 Ind. 280; Central Plank Road Co. *v.* Clemens, 16 Mo. 359, 365.

[5] Central Plank Road Co. *v.* Clemens, *supra*.

[6] Ohio &c. R. Co. *v.* McPherson, 35 Mo. 13, 27; *s. c.* 86 Am. Dec. 128. The court cited Trustees *v.* Hills, 6 Cow. (N. Y.) 23; *s. c.* 16 Am. Dec. 429; All Saints *v.* Lovett, 1 Hall (N. Y.), 198; John *v.* Farmers &c. Bank, 2 Blackf. (Ind.) 367; *s. c.* 20 Am Dec. 119.

collaterally to escape the performance of his contract.[1] But this principle ought not to extend so far as to require the subscriber to pay where the delay has been so long as to afford evidence of a total abandonment of the enterprise.[2] Moreover, the language of particular charters or contracts of subscription may be such as to make the commencement of the work within a given time a *condition precedent*, in which case a principle already discussed[3] will come into operation;[4] and especially where the charter requires a cash payment at the time of subscribing, sufficient to raise a fund with which to commence operations.[5] This principle is well illustrated by a decision in Texas. A statute of that State[6] provides that if any railway corporation organized under that title shall not, within two years after filing and recording its articles of association, begin the construction of its road, and construct and equip, etc., at least ten miles of its proposed road, such corporation shall "*forfeit its corporate existence* and its powers shall cease as far as it relates" to the unfinished part of the road, "and shall be incapable of resumption by any subsequent act of incorporation." The court held that the failure to begin the construction of the road within the two years works a forfeiture of corporate existence without any judicial proceedings for that purpose. The court reasoned further that a subscription to the stock of a corporation is presumed to be made with reference to the statute in force and governing the subject-matter at the time; and accordingly, where a railroad corporation had allowed the period prescribed by the above statute to elapse without beginning the construction of the road, a subscriber for stock is absolved from liability on his subscription, and the subscription cannot be revived by the subsequent passage of an act suspending the limitation, and fixing another date when such period shall begin to run, especially as a subsequent act restoring corporate existence would in effect be an act of incorporation, and would nullify the provision of the statute that corporate existence which has been forfeited thereunder shall be incapable of resumption by any

[1] Connecticut &c. R. Co. *v.* Bailey, 24 Vt. 476; *s. c.* 58 Am. Dec. 181.

[2] *Ante*, § 1272.

[3] *Ante*, § 1302, *et seq.*

[4] McCully *v.* Pittsburgh &c. R. Co., 32 Pa. St. 25.

[5] *Ante*, §§ 1322, 1724.

[6] Rev. St. Tex., art. 4278.

subsequent act of incorporation.[1] So, in a case in Pennsylvania, an act of assembly for the incorporation of a plank road company, provided that it *should be null and void*, unless the construction of the road was commenced within three years from that date. The construction was not commenced within the time specified, but a subsequent act was obtained in 1857, which extended the time and "*legalized and made valid*" the original subscriptions. In an action by the company, against one of the original subscribers, for his subscription, it was held that, as the act of incorporation had become null and void by the expiration of the time limited for the commencement of the road, the original subscriptions had also become void, and that no action could be maintained thereon. A contract, which has become void by force of its inherent conditions, cannot be re-instated by an act of assembly.[2] But mere *oral statements*, not amounting to valid conditions precedent in the contract of subscription, made by the agent of the corporation, or by its promoters, as to the time in which the work will be completed, although these statements take the form of distinct promises, are no part of the contract and a failure to perform them does not release the subscriber.[3]

§ **1975. Abandonment of the Enterprise.** — There is considerable authority for the proposition that it is not a good defense to such an action that the corporation has abandoned the enterprise for which it was created; but it is believed that the cases which so hold may be reconciled with those stated in the next section, on the ground that they either relate to cases of a partial abandonment either in point of time or manner, or to cases where the rights of *creditors* of the corporation supervene. The mere fact that the corporation — a railroad or plank road company — has *abandoned work* on its road will ordinarily be no defense, for this may have been compelled by lack of the very funds for which the corporation is suing.[4] It is no defense to an action on a subscription to the stock of a railroad corporation, that the company has not completed the road in its entirety,

[1] Bywaters *v.* Paris &c. R. Co., 73 Tex. 624; *s. c.* 11 S. W. Rep. 856.

[2] Plank Road Co. *v.* Davidson, 39 Pa. St. 435.

[3] Pickering *v.* Templeton, 2 Mo. App. 424; *ante*, §§ 1296, 1394.

[4] *Ante*, § 1272; Dorman *v.* Jacksonville Plank Road Co., 7 Fla. 265.

or that it has abandoned a *part* of the enterprise, when no condition to that effect is expressed in the subscription.[1] Thus, in an action on a note given in payment of a subscription to the stock of a corporation organized to build cotton and woolen mills, a plea alleging that the company had never erected cotten and woolen mills, but a cotton mill only, and that "the charter members of the corporation had organized it for their sole benefit, ignoring the right of the defendant," is not sufficient to show failure of consideration.[2] Moreover, the fact that a railroad is not completed within a certain time constitutes no valid defense, where it does not appear that time was of the essence of the contract, and it is admitted that the road has been built and that the benefits sought to be derived from it, and which were the inducements that led to the subscription, have accrued.[3] Nor is such a defense at all available where it appears that the corporation is indebted to more than the amount of the subscription, — as the action is prosecuted for the benefit of *creditors*, —[4] especially where the proceeding is prosecuted by a judgment creditor of the corporation in aid of his execution, inasmuch as the creditors of the company may pursue the stockholders, even after its corporate existence has ceased.[5]

§ 1976. Total Abandonment and Long Lapse of Time.— But there must be a limit to the doctrine of the preceding section, and that limitation seems to be this: that where there has been a total failure to enter upon the work contemplated by the charter or articles of association, or a total abandonment of such work, and in either case a long lapse of time thereafter, the subscribers ought not to be held to their contract unless the rights of creditors supervene. In some cases the lapse of time may be such that the law will *presume* an abandonment, at least of the contract of subscription.[6] In others the lapse of time will

[1] Armstrong *v.* Karshner, 49 Oh. St. 276; *s. c.* 24 N. E. Rep. 897.

[2] Dallas Cotton &c. Mills *v.* Clancey (Tex. App.), 15 S. W. Rep. 194.

[3] Kansas City &c. R. Co. *v.* Alderman, 47 Mo. 349.

[4] Phœnix Warehousing Co. *v.* Badger, 67 N. Y. 294.

[5] Bish *v.* Bradford, 17 Ind. 490; *post*, § 3341.

[6] Pittsburg &c. R. Co. *v.* Byers, 32 Pa. St. 22; *s. c.* 72 Am. Dec. 770 (abandonment of *contract* of subscription).

be sufficiently great under the circumstances as to take the *question to the jury*, and yet not so great as to enable it to be decided as a presumption or conclusion of law.[1] In still others *equity* will relieve the subscribers.[2]

§ 1977. **Illustrations.**— Applying the foregoing principles, it has been held that where no call is made for subscriptions to stock in a railroad company, until *more than six years* from the time of subscription, the *law will presume*, by analogy to the statute of limitations, that the company meant to abandon the contract, and will not enforce recovery.[3] In another such action in the same State, there was evidence that the company was incorporated in 1868, and that, by the act of incorporation and a supplementary act, the company was to have five years in which to begin work upon its road. In 1872 a small amount of grading was done upon it, but the work was abandoned in three months. In 1875 a contract was made with a firm of railroad builders, but nothing was done under the contract, and no further steps were taken by the company until 1882, when another contract was made for certain rails, etc., and horses and carts were sent to various sections of the road, but no actual work was done, although the company had issued mortgage bonds, and, in 1882, made a call for subscriptions. It was held that there was sufficient *evidence to go to the jury* on the question whether or not the company had abandoned the road.[4] Again, in a case in Kentucky where the subscription of stock under a charter was deemed inadequate to the purposes for which it was subscribed, and no action was taken, for upwards of *nine years*, to appoint directors or to appropriate the fund subscribed according to the charter, and the object contemplated by the charter was abandoned, — it was held that such of the subscribers as, on the faith of the abandonment, had changed their circumstances, and were no longer interested in the object, ought not to be compelled to pay their subscription, and were entitled to be *relieved in equity* therefrom.[5] So, in a case in Iowa it is

[1] Delaware &c. R. Co. *v.* Rowland (Pa.), 9 Atl. Rep. 929; *s. c.* 8 Cent. Rep. 814.

[2] Fountain Ferry Turnpike R. Co. *v.* Jewell, 8. B. Mon. (Ky.) 140.

[3] Pittsburgh &c. R. Co. *v.* Byers, 32 Pa. St. 22; *s. c.* 72 Am. Dec. 770.

[4] Delaware &c. R. Co. *v.* Rowland (Pa.), 9 Atl. Rep. 929; *s. c.* 8 Cent. Rep. 814.

[5] Fountain Ferry Turnpike R. Co. *v.* Jewell, 8 B. Mon. (Ky.) 140. Statutes have been enacted in England providing for the abandonment of railways and the dissolution and winding up of railway companies: "Abandonment of Railways Act, 1850" (13 & 14 Vict. ch. 83); "Railway Companies Act, 1867" (30 & 31 Vict. ch. 127); "Abandonment of Railways Act, 1869" (32 & 33 Vict. ch. 114). See Lind. Comp. 5th ed. 901.

held that a period of *fourteen years* is not a *reasonable time* within which to construct a railroad, so as to render subscribers to the capital stock liable on their notes made payable when the cars shall be running, where it was evidently the intent of the parties that the road should be completed within a reasonable time.[1]

§ 1978. Inadequacy of Means of Completing its Undertaking. — Subscribers to the stock of a railway company are not released from liability for subscriptions by the fact that the company has *suspended operations* upon its road; that it will require a large additional expenditure of labor and money to complete its construction, and even that the means of the company are wholly inadequate to accomplish its undertaking. The reason is, that it may be that the collection of the subscription is necessary for the payment of obligations already incurred; and in any event, "the defendant could only be absolved from liability for the payment of his stock by alleging and proving a *final abandonment* of the work by the company, and also that its payment was not necessary for the purpose of satisfying any existing demand against the corporation.[2]

§ 1979. Resolution to Wind Up.— Nor is it any defense to such an action that, before it was brought, a resolution to discontinue business and wind up the affairs of the corporation had been passed by the board of directors,[3] since a *cesser* of corporate business does not amount to a *dissolution* of the corporation, in the sense which disables it from suing to enforce contracts which have been made with it;[4] and moreover, it may still need funds to satify its creditors.

§ 1980. Sale or Lease of All the Corporate Property. — On the same reasons, the conclusion is unavoidable that it is no defense to such an action that the corporation has *leased* or *sold* its franchises to another, although the lease or sale may be void;[5]

[1] Blake *v.* Brown, 80 Iowa, 277; *s. c.* 45 N. W. Rep. 751.

[2] McMillan *v.* Maysville &c. R. Co., 15 B. Monr. (Ky.) 218; *s. c.* 61 Am. Dec. 181; *ante*, § 1272.

[3] Chouteau Ins. Co. *v.* Floyd, 74 Mo. 286, 290.

[4] State Nat. Bank *v.* Robidoux, 57 Mo. 446; Kansas City Hotel Co. *v.* Sauer, 65 Mo. 279, 288. Compare Hill *v.* Fogg, 41 Mo. 563.

[5] Troy &c. R. Co. *v.* Kerr, 17 Barb. (N. Y.) 581; Hays *v.* Ottawa &c. R. Co., 61 Ill. 422; Ottawa &c. R. Co. *v.* Black, 79 Ill. 262.

nor that, after the commencement of an action on such subscription, a *mortgage* executed by the plaintiff company was *foreclosed*, and its railroad and its franchises sold to purchasers who took possession;[1] nor that it has been seized by the governor of the State, under a statute, to satisfy the State's lien.[2] Where a stockholder pleaded, as a defense to such an action, that, by the terms of his subscription, it was to be paid when the road should be completed between certain points, whereupon he was to receive a certificate for a like amount of stock, and that the company had sold and leased the road,—his plea was held bad on demurrer, for the reason that, if the charter authorized the sale or lease, the party subscribing must have known that the power could be exercised; and if there was no such power conferred, then the sale and lease were void, and on payment and receipt of his certificate, he would hold his stock unimpaired, and there was not a failure of consideration.[3]

§ 1981. Changes in the Location, Route, Termini, of the Proposed Railroad, Plank Road, etc. — We have already discussed the question what changes in the proposed route of the railroad, plank road, etc., which the corporation is chartered or organized to build, not assented to by the particular subscriber, will be regarded in law as such an alteration of the contract or abandonment of the original undertaking, as discharges him from the obligation of his subscription.[4] We have seen that a substantial alteration in the *termini* of a railroad, so as to change entirely the nature of the scheme, will generally have this effect.[5] For instance, if a railroad company is chartered or organized under a general law to build a railroad from Chicago to St. Louis, and instead of this, should undertake to build a railroad from Quincy to Kansas City, it could not compel an original subscriber to contribute to the new enterprise unless he had consented to the change; for he never contracted to go into such a

[1] Buffalo &c. R. Co. *v.* Gifford, 87 N. Y. 294.

[2] Mullins *v.* North & South R. Co., 54. Ga. 580.

[3] Hays *v.* Ottawa &c. R. Co., 61 Ill. 422. See also Ottawa &c. R. Co. *v.* Black, 79 Ill. 262.

[4] *Ante*, § 66, *et seq*, and § 1268, *et seq*.

[5] *Ante*, §§ 74, 1282. Compare *ante*, § 77.

scheme. When, therefore, such a corporation purchases a *new railroad* and obtains a *new charter*, but fails to comply with its original charter as to the *termini* of its road, — an original subscriber, not consenting to the change, may set this up in defense against an action on his original subscription.[1] But a mere *formal irregularity* in the relocation of a railroad will not discharge a stockholder from liability to pay his assessments,— such as an omission to designate a point in a certain town as the end of one of the road sections, as in the original location.[2] Between the extremes indicated by these two cases many cases fall, — most of them holding that a failure to complete the road according to its original location is no defense to the subscriber where his subscription was unconditional.[3]

§ 1982. Illustrations of Opposing Theories on This Question. — The defense that the directors of the company, it being a plank road company, in locating the route, have departed from the route proposed in the articles of association, so as in fact to make it a different enterprise from that in which the defendant engaged, and different from that which is authorized under the law, has been held untenable. It is said that if they have thus violated their duty to the company and the law, the particular defendant is not more injured by it than every other member of the company. "If their act stands as the act of the company, and is such a departure from the route proposed in the articles, as to be a different enterprise, then the whole corporate franchise may be taken from the company by the appropriate proceeding. But in the present suit for an installment due upon the defendant's stock, this question cannot arise. The authorities cited * * * to show that an alteration in the charter of an incorporated company, made after the original subscription of the stock, materially changing the charter and objects of the company, discharges a subscriber from his obligation to pay upon his original subscription when he has refused to consent to any such alteration, do not apply to a case like the present."[4] This view is believed to be untenable. It is difficult to see upon what ground any distinction can be taken between the case of a material alteration of a charter, and a material deviation from the original purposes of the com-

[1] Chartiers R. Co. *v.* Hodgens, 77 Pa. St. 187.

[2] Boston &c. R. Co. *v.* Wellington, 113 Mass. 79.

[3] Smith *v.* Gower, 2 Duv. (Ky.) 17. Central Plank Road Co. *v.* Clemens, 16 Mo. 359.

[4] Central Plank Road Co. *v.* Clemens, 16 Mo. 359, 366.

pany, to further which the subscriber signed the contract of subscription, without the authority of a charter amendment. In either case the subscriber is entitled to say: "I agreed to contribute money to a certain venture; you cannot in consequence of this agreement compel me to contribute money to a wholly different project." He is clearly entitled to say this, unless his situation is such that he has by his own conduct estopped himself from saying it. - - - - A case in Indiana, though arising on somewhat different facts, seems to lie at the other extreme. The action was upon a subscription paper, by which the defendant promised to pay a certain sum to A, B, and C, in trust, to be expended within a county named, in constructing a railroad within certain limits, the persons named to select the corporation which should have the benefit of the subscription. The defendant answered that, when the instrument was executed by him, it was agreed that if the railroad was located through his farm, he should have the choice of paying the five hundred dollars or giving the right of way to the corporation, and that he had given such right of way, which had been accepted by the company. The court held that the answer showed a good defense. It did not involve a violation of the rule which excludes parol evidence of an agreement made contemporaneously with a written contract. The matter set up was admissible as showing an accord and satisfaction, and also as showing that the power or authority given to the persons named was not coupled with an interest, and was therefore revocable by the parties signing it at any time before it was executed.[1]

[1] Evansville &c. R. Co. *v.* Wright, 38 Ind. 64.

CHAPTER XXXII.

LIMITATIONS OF ACTIONS AGAINST STOCKHOLDERS.

ARTICLE I. GENERAL DOCTRINES.

§ 1986. Statutes of Limitation Apply Both at Law and in Equity. — It was formerly thought that statutes of limitation were not binding upon courts of equity, but that those courts, in discountenancing stale demands, merely acted by *analogy* to the periods limited in such statutes. Obviously, this doctrine could never gain a foothold in a country where all courts are bound equally by the legislative will. It is not the law of this country,[1] and it seems to have been abandoned in Great Britain. The

[1] 2 Story's Eq. Jur., § 1520; Baker *v.* Atlas Bank, 9 Metc. (Mass.) 195; Bassett *v.* St. Albans Hotel Co., 47 Vt. 313, 316; Carrol *v.* Green, 92 U. S. 509, 516; Commonwealth *v.* Cochituate Bank, 3 Allen (Mass.), 42; Lindsay *v.* Hyatt, 4 Edw. Ch. (N. Y.) 97.

subject was very fully considered by Lord Redesdale in Hovenden *v.* Lord Annesley,[1] in which he used the following language: "It is said that courts of equity are not within the statutes of limitations. This is true in one respect; they are not within the words of the statutes, because the words apply to particular legal remedies; but they are within the spirit and meaning of the statutes, and have been always so considered. I think it is a mistake, in point of language, to say that courts of equity act merely by *analogy* to the statutes; they act in *obedience* to them. Equity, which in all cases follows the law, acts on legal titles and legal demands, according to matters of conscience which arise, and which do not admit of the ordinary legal remedies; nevertheless, in thus administering justice according to the means afforded by a court of equity, it follows the law." The doctrine that courts of equity apply the statutes of limitations by analogy to suits at law has so far asserted itself, however, as to lead to the conclusion that in a suit in equity by a creditor against a shareholder, upon a debt of the corporation, the court will not treat the action as barred unless it would be barred in the courts at law, in any form of action which the creditor might have brought there.[2] But, in general, a court of equity will inquire in what form of action it would have been necessary for the plaintiff to proceed at law, and will apply the bar of the statute applicable to that form of action.[3]

§ 1987. Effect of Doctrine that Capital Stock is a Trust Fund.— Recurring again to the familiar American doctrine that the capital stock of a corporation is a trust fund for the benefit and security of creditors,[4] let us see whether the liability of a shareholder for unpaid balances due on his contract of subscription is not subject to the rule that the statute of limitations does not apply to express trusts. We have seen that in respect of such unpaid balances the stockholder is deemed in equity to be the custodian of a portion of the capital stock of the company, or of this trust fund.[5] Does this make him the trustee of

[1] 2 Sch. & Lef. 629.

[2] Van Hook *v.* Whitlock, 3 Paige (N. Y.), 409, 416.

[3] Carrol *v.* Green, 92 U. S. 509; Lindsay *v.* Hyatt, 4 Edw. Ch. 104; Corning *v.* McCullough, 1 N. Y. 47, 58; *s. c.* 49 Am. Dec. 287.

[4] *Ante*, § 1569.

[5] *Ante*, § 1573.

an express trust, of which the creditors of the corporation are the beneficiaries? Does this establish between him and them such a fiduciary relation as prevents the statute of limitations from running in his favor, until an open and unequivocal repudiation by him of that relation? In Georgia, Mississippi and Alabama this question has been answered in the affirmative.[1] The Supreme Court of Georgia has taken the view that such a case is one of "*direct trust*, purely technical, not cognizable at law, but falling within the proper, peculiar, and exclusive jurisdiction of a court of equity; and consequently one not subject to the presumption of payment, or satisfaction or waiver."[2] The Supreme Court of Mississippi has placed its judgment upon similar grounds. "The decisions of this court," said Clayton, J., "hold the stock subscribed to a bank to be in the nature of a trust fund for the payment of its liabilities.[3] This trust fund is usually administered by the directory, as the agent of the stockholders; and after the payment of the stock, the directory is alone looked to for its faithful management. But before its payment, the stockholders themselves are chargeable with the trust, in favor of the creditors of the bank. The stock is the fund which the creditors trust. They have no direct means of compelling its payment until they have obtained judgments at law. They become the beneficiaries of the trust by receiving the notes, and the stockholders, as the persons bound by the trust, cannot oppose the statute of limitations to their claim to have the stock paid up. If the corporation does not compel payment of the stock, the subscribers must be deemed to hold it for the corporation, subject to its call. It is a continuing, subsisting trust and confidence to which the statute of limitations has no application. Test the principle by the converse state of facts. Suppose the stock to be all paid; the bank to go on prosperously; that no dividends are declared, but the whole is permitted to accumulate until the charter is about to expire; then, that the stockholders claim their respective amounts of

[1] Hightower *v.* Thornton, 8 Ga. 486, 502; Payne *v.* Bullard, 23 Miss. 88; *s. c.* 55 Am. Dec. 74; Curry *v.* Woodward, 53 Ala. 376.

[2] Hightower *v.* Thornton, 8 Ga. 486, 502; *s. c.* 52 Am. Dec. 412.

[3] Citing, King *v.* Elliot, 5 Smed. & M. (Miss.) 447; Arthur *v.* Commercial &c. Bank, 9 Smed. & M. (Miss.) 430.

stock, with the accrued profits; but the directors refuse to pay, and interpose the statute of limitations to that part which is of more than six years' standing. No one can believe that the statute would bar in such a state of the case, because of the trust reposed. There is no adverse holding; the stockholders compose the corporation. The same principle must govern this case."[1] But, without giving an authoritative opinion on this point, the court intimated that from the time the bank ceased to elect a directory or to carry on business it might perhaps be held that there was a cessation of the trust, so that the statute would then begin to run.[2] The Supreme Court of Alabama, in a later case pursues the same course of reasoning, and adopts the conjecture of the Supreme Court of Mississippi, that the statute would begin to run from the time of an evident disbandment of the company and cessation of business. "As long as the company was organized," said Manning, J., "and doing business, these relations between it and the stockholders, and this recognition by them of these moneys as a part of its capital, continued. During this time there was no adversary attitude or claim from which the statute of limitations could begin to run against it. And we presume no one of the stockholders imagined that if the business was prosperous, so that for six, eight or ten years, instead of having to pay this money in, they were receiving dividends from the income, and if afterwards, in consequence of losses by fire or otherwise, it became necessary in order to pay its policies, to raise more money than the company had, he could set up the statute of limitations in opposition to a call to pay in his stock. There would be, in such a case, by virtue of their relations and participation in the profits, an acknowledged continuing liability for it to the company. Until the call was made or there was an evident disbandment of the company and relinquishment of business, the statute of limitations would not begin to run."[3]

§ 1988. Whether Shareholder's Liability is in the Nature of a Specialty Debt.—Many of the American States borrowed from England the statute of 21 James I. c. 16, which provides

[1] Payne *v.* Bullard, 23 Miss. 88; *s. c.* 55 Am. Dec. 74.

[2] Payne *v.* Bullard, 23 Miss. 88; *s. c.* 55 Am. Dec. 74.

[3] Curry *v.* Woodward, 53 Ala. 371, 376.

that "all actions of debt *without specialty* * * * shall be brought within six years." It was therefore a part of the early law of many of the United States that specialty debts were not within the statute of limitations. This rule, no doubt, lingers in some of the States where it has not been changed by statute;[1] and even in those States where it has been changed, the statutes generally prescribe a longer period to bar specialty debts than that required to bar simple contract debts. In England, and in those States of the American Union where the statute of limitations excepts specialty debts, the courts have enacted a statute of their own by raising a *presumption of payment* after the lapse of twenty years.[2] The question whether the liability of a shareholder to respond to creditors for the debts of the corporation is in the nature of a specialty debt is therefore a material one in many of the States. This question appears to have arisen in England, for the first time, in 1856, in a case which received two arguments before Lord Chancellor Cranworth and the lords justices, at the second of which two of the law judges, Mr. Justice Cresswell and Mr. Baron Martin, were called in. The question, as presented, was whether, a company being in process of winding-up, a call made by a master upon a shareholder, under the Winding-up Acts, was a specialty debt. It was urged that it was such a debt, since the authority to make the calls grew out of the covenants of the company's *deed* of settlement. But the court unanimously held otherwise, affirming the decision of Vice-Chancellor Stuart, assisted by Mr. Justice Erle.[3] This, it seems, should have settled the question; but ten years later Vice-Chancellor Kindersley held that the liability of a retired shareholder, under a deed of settlement which provided that retiring shareholders (that is, those whose shares had been transferred or forfeited) should be liable for their proportion of the losses of the company incurred before they ceased to be members, was a liability by way of specialty, because the clause of the deed which constituted the contract among the shareholders was an agreement under seal.[4] The New Jersey

[1] See Ang. on Lim., § 79, *et seq.*

[2] *Ibid*, § 93.

[3] Robinson's Executor's Case, 6 De G. M. & G. 572.

[4] Helby's Case, L. R. 2 Eq. 167. See also Cork &c. R. Co. *v.* Goode, 13 C. B. 826. That calls made under a colonial act are simple contract debts

statute declares that "all actions * * * founded upon any lending or contract without specialty * * * shall be commenced and sued within six years next after the cause of such action shall have accrued, and not after."[1] It is held in that State that this limitation is not applicable when the entire cause of action arises out of a statute, for the reason that, then, the action rests on a specialty.[2] Following this construction of the New Jersey statute, the Circuit Court of the United States for the District of Massachusetts has held that the New Jersey statute cannot be invoked in that court to defeat a suit in equity brought by the receiver of a New Jersey corporation to enforce against stockholders a liability imposed by the New Jersey statute for the corporate debts.[3]

§ 1989. Continued: How in Case of Statutory Liability.— It is old law that a liability founded on a *statute* is in the nature of a *specialty*.[4] Such a liability was, therefore, not within the statute of James,[5] and in this country is subject only to the bar of the statute, or to the presumption of payment after the lapse of twenty years. A statutory liability of the shareholders of a corporation to its creditors has been held to be in the nature of a specialty, and within this rule.[6] But this doctrine has been denied by the Supreme Court of the United States, in a case which, it is thought, must be regarded as overruling Bullard *v.* Bell,[7] which was pressed upon the attention of the court.[8] The

merely, see Welland R. Co. *v.* Blake, 6 H. & N. 410, 415.

[1] N. J. Rev. 594, ed. 1860.

[2] Cowenhoven *v.* Freeholders, 44 N. J. L. 232.

[3] Andrews *v.* Bacon, 38 Fed. Rep. 777.

[4] Com. Dig., Temps (G. 15); Jones *v.* Pope, 1 Saund. 37; Hodsden *v.* Harridge, 2 Saund. 61, 65; Talory *v.* Jackson, Cro. Car. 513; Bullard *v.* Bell, 1 Mason (U. S.), 289; Shepherd *v.* Hills, 32 Eng. Law & Eq. 533; Pease *v.* Howard, 14 Johns. (N. Y.) 480; Griffin *v.* Heaton, 2 Bailey, 58; Ward *v.* Reeder, 2 Har. & McH. (Md.) 154; Lane *v.* Morris, 10 Ga. 162; Thornton *v.* Lane, 11 Ga. 459.

[5] 21 Jas. I. c. 16, § 3.

[6] Bullard *v.* Bell, 1 Mason (U. S.), 289; Thornton *v.* Lane, 11 Ga. 459, 502; Lane *v.* Morris, 10 Ga. 162.

[7] 1 Mason (U. S.), 243.

[8] Carrol *v.* Green, 92 U. S. 509, 515. It has been held in New York that the section of the statute of limitations of that State limiting the bringing of actions to three years for any forfeiture or cause, upon any statute made or to be made, the benefit or suit whereof was given to the party aggrieved, did not embrace actions for statutory liabilities, such as actions given to creditors against stockholders, but was limited to private actions on penal statutes. Van Hook *v.* Whit-

word "specialty" and the words "contract under seal" are convertible terms;[1] and yet where the legislature, instead of using the word *specialty*, as in the statute of James, provided that "all actions of debt founded upon any contract or liability *not under seal* * * * shall be commenced within six years," etc., it was held that it was the intention of the legislature not to exclude any statutory liability. "Here," said the court, "the words 'contracts under seal' and 'liability' are plain words, the meaning of which is too obvious and clear to be misunderstood; and if the legislature intended to except from the operation of the statute liabilities created by statute, it must be presumed that it would have been so expressed."[2]

§ **1990. What are Statutory Liabilities.** — An action by a creditor of a manufacturing company, to enforce the individual liability of the stockholders, is "an action upon a liability created by statute,"[3] and must therefore be brought within six years.[4] - - - - Where a corporation is chartered for the purpose of insuring the lives of its members, upon the payment by each of such sum or sums as may be prescribed by the laws and regulations of the corporation, and its charter provides that the amount due upon the decease of a member shall be paid to the person entitled to the same according to the by-laws, or to such person as may have been designated by his last will, and where, according to the by-laws, this amount and the time of its payment are dependent upon the general provisions of the by-laws themselves, the liability of the corporation to make such payment is a statutory liability, and the period of limitation applicable to an action to enforce payment is, under Georgia Code, § 2916, twenty years.[5]

lock, 26 Wend, 43; *s. c.* 37 Am. Dec. 246; Lindsay *v.* Hyatt, 4 Edw. Ch. (N. Y.) 97; Corning *v.* McCullough, 1 N. Y. 47; *s. c.* 49 Am. Dec. 287; overruling Freeland *v.* McCullough, 1 Denio (N. Y.), 414; *s. c.* 43 Am. Dec. 685. Such demands were subject to the statute of six years. *Ibid.* This view proceeds upon a theory of the New York courts, already alluded to, that stockholders are liable, in an original and primary sense, like partners, and that their liability is not created by statute.

[1] Baker *v.* Atlas Bank, 9 Metc. (Mass.) 197, per Wilde, J. "Nothing is a specialty but a writing under seal." Thornton *v.* Lane, 11 Ga. 502, per Lumpkin, J.

[2] Baker *v.* Atlas Bank, 9 Metc. (Mass.) 182.

[3] Ohio Rev. Stat., § 4981.

[4] Hawkins *v.* Iron Valley Furnace Co., 40 Oh. St. 407.

[5] Georgia Masonic Ins. Co. *v.* Davis, 63 Ga. 471.

§ 1991. What Statute Applicable in Actions by Creditors Against Stockholders. — There is some confusion among the authorities on the question whether an action by creditors of the corporation against stockholders is governed by the statute of limitations relating to actions upon *contracts*, or by the statute relating to actions upon *statutory liabilities*. The true solution of this question will, it is believed, be found in recurring to the consideration that, at common law, a creditor has no such right of action; since his debtor is the corporation, which is a different legal person from that of one of its stockholders; since the stockholder is not a partner, and since there is no privity of contract between him and the stockholder. And while it is true that the rights of the creditor may be worked out against the stockholder *in equity* on the theory that the assets of the corporation are an equitable trust fund for creditors, and that, in so far as any stockholder is indebted to the corporation in respect to his shares, he is the holder of a certain portion of this trust fund, — yet it is to be remembered that the statute of limitations did not bind the court of chancery in England, except by way of analogy.[1] Without the aid of a statute, therefore, the creditor has no remedy directly against the stockholder. It is therefore a *statutory remedy*,[2] and is governed by the statute of limitations applicable to such remedies, and not by the statute applicable to actions upon contracts.[3]

§ 1992. Illustration: California Statute of Three Years. — Section 359 of the California Code of Civil Procedure enacts: "This

[1] Compare on this point Van Hook *v.* Whitlock, 26 Wend. (N. Y.) 43; *s. c.* 37 Am. Dec. 246; *ante*, § 1986.

[2] Terry *v.* Little, 101 U. S. 216; Salt Lake City Bank *v.* Hendrickson, 40 N. J. L. 52; *s. c.* 6 Reporter, 212.

[3] Hyman *v.* Coleman, 82 Cal. 650; *s. c.* 23 Pac. Rep. 62; Green *v.* Beckman, 59 Cal. 545; *s. c.* 8 Pac. L. J. 645. It was so held in Freeland *v.* McCullough, 1 Denio (N. Y.) 414; *s. c.* 43 Am. Dec. 685; but this case was overruled on this point in Corning *v.* McCullough, 1 N. Y. 47; *s. c.* 49 Am. Dec. 287. In this last case it was held that a suit against a stockholder of a corporation, to charge him individually with a debt contracted by it, under a provision in the act of incorporation rendering the stockholders liable, is not barred by the three years' limitation, provided by 2 Rev. Stat. N. Y. 298, Sec. 31, for "actions upon a statute, for a forfeiture or cause, the benefit and suit whereof is limited to the party aggrieved;" the action being given partly by the common law, and partly by the statute; and it is only barred by the lapse of six years.

title does not affect actions against directors or stockholders of a corporation to recover a penalty or forfeiture imposed, or to enforce a liability created by law; but such actions must be brought within three years after the discovery, by the aggrieved party, of the facts upon which the penalty or forfeiture attached or the liability was created." As the individual liability of a stockholder to pay the debts of the corporation did not exist at common law, such liability, though not in the nature of a penalty or forfeiture, is held to be a liability created by law,— that is, by the constitution and statute law, within the meaning of the above statute. It follows that an action by a creditor to charge a stockholder in respect of a debt of the corporation may be brought at any time within three years after the discovery by the creditor of the facts by which the liability was created, and *a fortiori*, within three years after the contracting of the indebtedness by the corporation.[1]

§ 1993. Application of Statutes of Limitation to Different Forms of Action.— There lingers yet, in some of the States, a system under which a different period of limitations will be found applicable to different forms of action at law; and a considerable portion of a standard American work on the limitation of actions is devoted to a discussion of this subject.[2] A case in the Supreme Court of the United States, which went from South Carolina, and which involved a construction of the statute of that State, passed in the year 1712, which is somewhat similar to the statute of James I.,[3] calls the subject again to mind. In a learned opinion by Mr. Justice Swayne, the court held that the liability of stockholders is not an action grounded on a statute, and hence in the nature of a specialty, but is an action on the

[1] Green *v.* Beckman, 59 Cal. 545; *s. c.* 9 Am. Corp. Cas. 24.

[2] Ang. on Lim., *passim.*

[3] The statute provided "that * * * all actions of account, *and upon the case* (other than such account as concerns the trade of merchandise), * * * all actions of debt *grounded upon any* lending *or contract without specialty,* all actions of debt for arrearages of rent reserved by indenture, all actions of covenant, * * * which shall be sued or brought at any time after the ratification of this act, shall be commenced and sued within the time of limitation hereafter expressed, and not after; that is to say, *the said actions upon the case* other than for slanders, and the said actions for accounts * * * *and the said actions for* * * * *debts,* * * * within three years next after the ratification of this act, or within four years next after the cause of such actions or suits, and not after." See Ang. on Lim. (App.) 97, 98.

case, and as such, under the statute in question, barred in four years.[1]

§ 1994. Power of Legislature to Shorten Statutes of Limitation.— It is the settled law of this country that an enactment reducing the time prescribed by statutes of limitation in force when the right of action accrued is not unconstitutional, as impairing the obligation of contracts, provided a reasonable time be given for the commencement of a suit before the bar of the statute takes effect.[2] "In all such cases," says Waite, C. J., "the question is one of reasonableness; and we have therefore only to consider whether the time allowed in the statute is, under all the circumstances, reasonable. Of that the legislature is primarily the judge; and we cannot overrule the decision of that department of the government unless a palpable error has been committed. In judging of that, we must place ourselves in the position of the legislators, and must measure the time of limitation in the midst of the circumstances which surrounded them, as nearly as possible; for what is reasonable in a particular case depends upon its particular facts."[3] In this view the following statute of Georgia, passed *nine months and seventeen days* before the bar named in it would attach, was held not unconstitutional: "That all actions on bonds or other instruments under seal, and all suits for the enforcement of rights accruing to individuals or corporations under the statute or acts of incorporation, or in any way by operation of law, which accrued prior to the 1st of June, 1865, not now barred, shall be brought by the 1st of January, 1870, or the right of the party, plaintiff or claimant, and all right of action for its enforcement, shall be forever barred."[4]

[1] Carrol *v.* Green, 92 U. S. 509.

[2] Terry *v.* Anderson, 95 U. S. 628; Sohn *v.* Waterson, 17 Wall. (U. S.) 596; Christmas *v.* Russell, 5 Wall. (U. S.) 290; Sturges *v.* Crowninshield, 4 Wheat. (U. S.) 122; Hawkins *v.* Barney's Lessee, 5 Pet. (U. S.) 457.

[3] Terry *v.* Anderson, 95 U. S. 633.

[4] Terry *v.* Anderson, 95 U. S. 633. The chief justice expressed, on the particular case, the following views: "The liability to be enforced in this case is that of a stockholder, under an act of incorporation, for the ultimate redemption of the bills of a bank swept away by the disasters of a civil war which had involved nearly all of the people of the State in heavy pecuniary misfortunes. Already the holders of such bills had nearly four years within which to enforce their rights. Ever since the close of the war the bills had ceased to pass from hand to hand as money, and had become subjects of

The Supreme Court of Georgia[1] and the Circuit Court of the United States for the Southern District of Georgia had[2] previously reached the same conclusion. The Supreme Court of Georgia has, however, applied to this statute the doctrine that the statute does not begin to run until a call is made, and a right of action against the shareholders thus created on behalf of the corporation. When, therefore, a corporation became insolvent and ceased business, leaving a portion of its stock subscription uncalled for, in respect of this, judgment creditors were not barred by the statute.[3] A statute creating a remedy by action on the case against stockholders by creditors, in place of the remedy by *scire facias* on judgment against the corporation, and providing that such action on the case must be brought within *six months* after the rendition of judgment against the corporation, has been upheld in Maine.[4]

§ 1995. **What is the Commencement of an Action?** — The question sometimes arises, when an action is deemed to have been commenced so as to save the bar of the statute of limitations. Under a statute of Georgia, barring actions founded on corporate liabilities in certain cases unless commenced on or before the first day of January, 1870, it appeared that suit against a bank was commenced in 1866, and notice was given to stockholders by publication, under the provisions of the Georgia code. There were a judgment, execution, and return of *nulla bona* against the bank; upon which execution issued in June, 1869, against a stockholder, which was returned *nulla bona* in

bargain and sale as merchandise. Both the original bill-holders and the stockholders had suffered from the same cause. The business interests of the entire people of the State had been overwhelmed by a calamity common to all. Society demanded that extraordinary efforts be made to get rid of extraordinary embarrassments, and permit a reorganization upon the basis of the new order of things. This clearly presented a case for legislative interference, within the just influence of constitutional limitations. For this purpose the obligations of old contracts could not be impaired, but their prompt enforcement could be insisted upon or an abandonment claimed. That, as we think, has been done here, and no more. At any rate, there has not been such an abuse of legislative powers as to justify judicial interference." Terry *v.* Anderson, 95 U. S. 628, 633.

[1] George *v.* Gardner, 49 Ga. 441.

[2] Samples *v.* The Bank, 1 Woods (U. S.), 523.

[3] Cherry *v.* Lamar, 58 Ga. 541.

[4] Cummings *v.* Maxwell, 45 Me. 190.

July, 1869, and afterwards a levy was made — presumably under the same execution, but the case is silent on this point — in August, 1870. It was held that the suit against the stockholder began, at most, with the issue of the execution in June, 1869, and it therefore saved the bar of the statute, though not levied until after the bar would have attached.[1] A suit by one creditor for himself and *all other creditors* of an insolvent corporation, to enforce the statutory liability of its stockholders, saves the running of the statute of limitations as against all the creditors who may come in and assert their claims before its final determination.[2]

§ 1996. **Doctrine of Stale Demand.** — The Supreme Court of Georgia has refused to apply the doctrine of stale demand to a bill in equity to call in, for the benefit of the creditors of an insolvent corporation, the moneys due by the stockholders on account of their subscriptions, where five years only had elapsed from the time when the *legal* assets of the corporation were exhausted, at which time, in the opinion of the court, the right to go into equity accrued.[3] A recent American case is to the effect that a suit to enforce the rights of the holders of a certificate given by an association to an Indian guide for a certain undivided share of the interest of the company in mining property, which is recognized by a corporation into which the company is formed, and a resolution adopted reciting the issue of non-assessable stock therefor, — is not barred by laches during the time of the life of the corporation so long as the rights thus

[1] Stone *v.* Davidson, 56 Ga. 179.

[2] Barrick *v.* Gifford, 47 Oh. St. 180; *s. c.* 21 Am. St. Rep. 798.

[3] Hightower *v.* Thornton, 8 Ga. 486, 502; *s. c.* 52 Am. Dec. 412. See also the case of Turquand *v.* Kirby, L. R. 4 Eq. 123, in which case shares remained in a testator's name on the books of the company for nine years after his death, the dividends being paid to his executor, who retained the shares. On the winding-up of the company at the end of nine years, the shares still standing in the name of the testator, Lord Romilly, M. R., held it to be clear that the statute of limitations had nothing to do with the case; for the debt, though not existing when the testator died, did not arise till the call was made; therefore, all the property of the testator in the hands of the executor and devisees was made liable for calls upon the winding-up, property of the testator exempt from the decree being only such as was in the hands of a purchaser for value before the date of the winding-up order.

appearing of record are not repudiated.[1] It has been held that as between the company and a stockholder, by analogy to the statute of limitations, where work on a railroad had not been prosecuted according to the requirements of the act of incorporation, and no calls made within six years from the date of the subscription for stock, a presumption of *abandonment of the undertaking* arose in favor of the subscriber, and that the lapse of six years was a bar to the remedy by call, and to a suit to recover the installments so called for.[2]

§ **1997. When Defense not Raised by Demurrer.** — Where it is sought to raise the defense of the statute of limitations by demurrer it must affirmatively appear from the complaint that the action is barred by some provision of the statute. Unless, therefore, there is an averment in the complaint of the existence of some fact which would put the statute in motion, as that a call had been made upon the stockholder by the directors, or that the company had, at a date named, disbanded or ceased business, a demurrer founded on the statute of limitations will be overruled.[3]

§ **1998. When Declaration Required to Negative Statute.** — The plaintiff is not ordinarily required, in stating his cause of action, to state a case which negatives the statute of limitations, — that is, which shows that his right of action is *not barred* by the statute. But there are exceptions to this rule. Thus, there can be no recovery against a stockholder for a debt of the corporation which is barred by limitation,[4] nor can a debt which is barred by limitation be proved in winding up a company under the English Companies acts.[5] It is not clear, however, that the stockholder should be required to exhibit such a debt affirmatively in his declaration or complaint. But where the governing statute makes it a *condition precedent* to the liability of the stockholder that an action should be brought against the corpo-

[1] Kobogum *v.* Jackson Iron Co., 76 Mich. 498; *s. c.* 43 N. W. Rep. 602.

[2] McCully *v.* Pittsburgh &c. R. Co., 32 Pa. St. 25; Pittsburgh &c. R. Co. *v.* Byers, 32 Pa. St. 22; *s. c.* 72 Am. Dec. 770; Pittsburgh &c. R. Co. *v.* Graham, 36 Pa. St. 77. See *ante*, §§ 67, 1272.

[3] Harmon *v.* Page, 62 Cal. 448; *s. c.* 9 Am. Corp. Cas. 29, 36.

[4] *Post*, § 3116.

[5] Mitchell's Claim, L. R. 6 Ch. 822.

ration upon the debt within a stated period from the time when it became due,— the fact that the action against the corporation was so brought must be averred in the declaration in the action against the stockholder; otherwise no right of action is exhibited.[1] So, under the statute of Iowa, in order to bar an action against a stockholder of a corporation to subject his unpaid balance on stock to the satisfaction of a judgment obtained against the corporation on its note given within five years, it is necessary not only to show that the note was given for a debt which accrued more than five years previous to the commencement of the action but that at the date of the note, the indebtedness of the corporation could not have been collected by the plaintiff.[2]

§ 1999. State Adjudications how far Binding on Federal Courts.—Under the well-known rule that the decisions of the State courts, construing their own statutes, are binding upon the Federal courts, it has been held that where a State court orders an assessment upon the shareholders of an insolvent corporation, and adjudges that lapse of time between the date of its decree and the failure of the corporation does not preclude relief, either under the statute of limitations or under the equitable doctrine of *laches*,— a court of the United States will entertain a collateral action to enforce the liability of the stockholder to an assessment, unaffected by defense of limitation or lapse of time.[3]

ARTICLE II. WHEN THE STATUTE BEGINS TO RUN.

[1] Tarbell v. Page, 24 Ill. 46.

[2] Tama Water Power Co. v. Hopkins, 79 Iowa, 653; s. c. 44 N. W. Rep. 797.

[3] Hawkins v. Glenn, 131 U. S. 319; s. c. 33 L. ed. 184; 9 Sup. Ct. Rep. 739; Glenn v. Liggett, 135 U. S. 533. See also Andrews v. Bacon, 38 Fed. Rep. 777.

§ **2002. General Doctrine.**—It is obvious that the statute begins to run from the date when the liability of the shareholder becomes fixed, in the sense that the creditor may, without obstruction, proceed against him. This period will be different according to the nature of the liability to which the law subjects the shareholder in a given case.[1]

§ **2003. Does not Begin to Run until a Call has been Duly Made.**—We have already seen that under ordinary contracts of subscription, the subscriber is under no obligation to pay anything beyond the first deposit until an assessment has been made by the directors, and he has been duly notified thereof;[2] though under some contracts and some judicial holdings, his obligation to pay is absolute, irrespective of his being notified of an assessment,[3] in which case the statute begins to run from the date of the subscription.[4] Where such an assessment and notice, called collectively a "call," are necessary in order to give the corporation a right of action, the statute of limitations obviously does not begin to run in favor of the stockholder and

[1] See a learned article on this subject, collecting many American decisions, by D. H. Pingrey, Esq., in 6 Rail. & Corp. L. J. 82. Thompson *v.* Reno Savings Bank, 19 Nev. 171; *s. c.* 3 Am. St. Rep. 881.

[2] *Ante*, § 1702.

[3] *Ante*, § 1703.

[4] See for illustration, Williams *v.* Meyer, 41 Hun (N. Y.), 545; *s. c.* 11 N. Y. Civ. Pro. 42; 3 N. Y. St. Rep. 360.

against the company, until such assessment has been duly made[1] and notified, and it does begin to run from that time.[2] The statement will be at once more accurate and more generally applicable if we say that the statute of limitations does not begin to run in respect of the right of action of the corporation against its shareholder for assessments, until the assessments have been made *and the right to sue therefor has accrued.*[3] Thus, where the subscriptions were payable within a certain time after notice, by the company calling for them, it was held that the statute of limitations did not begin to run until that time.[4]

§ 2004. **Where the Statute Allows a Period of Grace after the Call.**— This will better appear if we consider that under the provisions of some statutes and special charters thirty days must elapse after the making of the call before the right of action accrues. This must of course be taken into account in determining the period of time at which the statute begins to run. In these cases, until the stock is called for and the additional period of grace allowed the subscriber within which to respond to the call has elapsed, the relation between the stockholder and the corporation is a continuing relation of trust and confidence, to which the statute of limitations has no application.[5]

§ 2005. **Where the Call is Made by Order of Court, or Otherwise for Purposes of Liquidation.** — The rule is the same where the call is made by, or under authority of a court of justice, or by a receiver, or official liquidator, or by the directors

[1] Williams *v.* Taylor, 120 N. Y. 244; *s. c.* 30 N. Y. St. Rep. 646; 24 N. E. Rep. 288.

[2] Lewis *v.* Glenn, 84 Va. 947; *s. c.* 6 S. E. Rep. 866. This statute of limitations has been held to run in favor of subscribers to corporate stock from the time when a decree made an assessment, and not from the time when the corporation, not having made a call, executed an assignment for the benefit of creditors. Glenn *v.* Semple, 80 Ala. 159.

[3] Baltimore &c. Co. *v.* Barnes, 6 Harr. and J. (Md.) 57; Taggart *v.* Western Maryland R. Co., 24 Md. 563; *s. c.* 89 Am. Dec. 760; Gibson *v.* Columbia &c. Turnp. Co., 18 Oh. St. 396; Macon &c. R. Co. *v.* Vason, 52 Ga. 326; Glenn *v.* Foote, 36 Fed. Rep. 824; *s. c.* 5 Rail. & Corp. L. J. 136. Cherry *v.* Lamar, 58 Ga. 541; Curry *v.* Woodward, 53 Ala. 376; Glenn *v.* Williams, 60 Md. 93; Harmon *v.* Pope, 62 Cal. 448.

[4] Kent County R. Co. *v.* Wilson, 5 Del. 49.

[5] Payne *v.* Bullard, 23 Miss. 88; *s. c.* 55 Am. Dec. 74.

acting as trustees under a statute after insolvency. In all such cases, until the call has been made and a right of action to collect the same has accrued, the statute does not begin to run in favor of the stockholder. And where the call is made by an order of court, to be notified and enforced by its receiver, the statute does not begin to run until the date of the order;[1] and on the other hand, it does begin to run from that time.[2]

§ 2006. Whether Call by Corporation Puts the Statute to Running as Against Creditors.—It would seem that, except in those cases where the call is made on behalf of creditors, as stated in a preceding section, a call by the corporation, while a going concern, would not put the statute into operation *as against its creditors;* because this does not give *them* a right of action against the stockholders, and besides they may have no knowledge of the fact of the call being made.[3]

§ 2007. General Power to Receiver is not a Call.—Where, in a suit by stockholders to prevent waste, a receiver was appointed with the provision that "if there shall be any sums due upon the shares the receiver will collect the same, and may prosecute actions therefor," it was held that this did not amount to a call for the unpaid subscriptions so as to make the statute of limitations begin to run.[4]

[1] Hawkins *v.* Glenn, 131 U. S. 319; *s. c.* 33 L. ed. 184; 9 Sup. Ct. Rep. 739; Glenn *v.* Saxton, 68 Cal. 353; *s. c.* 9 Pac. Rep. 420; Great West. Tel. Co. *v.* Gray, 122 Ill. 630; *s. c.* 19 Am. & Eng. Corp. Cas. 260; 14 N. E. Rep. 214; 11 West. Rep. 739; 27 Am. L. Reg. (N. S.) 160; Glenn *v.* Semple, 80 Ala. 159; *s. c.* 60 Am. Rep. 92; Lehman *v.* Glenn, 87 Ala. 618; *s. c.* 6 South Rep. 44; Glenn *v.* Liggett, 135 U. S. 533; *s. c.* 34 L. ed. 262; 8 Rail. & Corp. L. J. 52; 10 Sup. Ct. Rep. 867; Glenn *v.* Howard, 81 Ga. 383; *s. c.* 8 S. E. Rep. 636; Semple *v.* Glenn, 91 Ala. 245; *s. c.* 24 Am. St. Rep. 894.

[2] A right of action for an assessment on unpaid subscriptions to the stock of an insolvent corporation accrues *when a decree of court is made* calling for such assessments. Vanderwerken *v.* Glenn, 85 Va. 9; *s. c.* 6 S. E. Rep. 806; Glenn *v.* Foote, 36 Fed. Rep. 824. When the stock and property of a manufacturing company organized under the New York act of 1848 are sequestered through a receiver, the statute of limitations begins to run in favor of the stockholder. Hollingshead *v.* Woodward, 107 N. Y. 96; *s. c.* 10 N. E. Rep. 621; 9 Cent. Rep. 456.

[3] Allibone *v.* Hager, 46 Pa. St. 48, 54.

[4] Glenn *v.* Macon, 32 Fed. Rep. 7.

§ 2008. Rule in Pennsylvania. — In Pennsylvania, the statute does not in general begin to run against a subscription until a call has been made; yet the call must be made *within six years*, the period of limitation of the statute, or the delay be satisfactorily accounted for, or else a recovery on the subscription will be barred.[1] In an action of debt against a corporation and its shareholders, to enforce a contract of the former and a statutory liability of the latter, the Supreme Court of Pennsylvania has held the statute of limitations to have no application, but upon the ground that the statute governing the corporation declared a continuing liability on the part of shareholders "until the whole amount of the capital stock, as fixed and limited by the said company, as in the act provided, shall have been paid in, and a certificate thereof shall have been recorded."[2] In an earlier case in the same State, — that of a *scire facias* against stockholders, founded on a judgment against the corporation, where one defense was the statute of limitations, — the court held that they could have no defense except that they were not stockholders, and that the debt was for a loan of money.[3] But this point was not specially considered; nor can the case be quoted as holding such a rule as that the statute of limitations would not run in favor of the stockholder from the date of the judgment against the corporation.

§ 2009. Does Not Run Against Creditors until a de Facto Dissolution. — If we recur to the doctrine that the capital stock of a corporation is a trust fund for its creditors, and that a portion of this capital is the unpaid balance in the hands of shareholders, we shall see ground for the conclusion that the statute of limitations does not commence to run at least until there has been such a dissolution of the corporation, in fact, not necessarily in law, as opens the road of the creditor to the stockholder. Under this theory where the liability is for unpaid balances on stock subscriptions, there is authority for the position that the statute does not begin to run (if at all) before a notorious disbandment

[1] Pittsburgh &c. R. Co. *v.* Byers, 32 Pa. St. 22; *s. c.* 72 Am. Dec. 770; McCully *v.* Pittsburgh &c. R. Co., 32 Pa. St. 25; Pittsburgh &c. R. Co. *v.* Graham, 36 Pa. St. 77; *s. c.* 2 Grant Cas. (Pa.) 259. Where more than eleven years elapsed from the first call on a stock subscription, before a second call was made, it was held that the statute of limitations of six years was a bar to an action by the corporation therefor. Shackamaxon Bank *v.* Disston, 4 Pa. County Ct. 201; *s. c.* 2 Rail. & Corp. L. J. 62.

[2] Allibone *v.* Hager, 46 Pa. St. 48, 55.

[3] Wilson *v.* The Stockholders, 43 Pa. St. 424.

of the company, and cesser of business,[1] or, as has been said, until the corporation ceases to elect a directory;[2] or until *dissolution* by a general *assignment for creditors*, and then it begins to run.[3] The reason is that which applies to statutes of limitations generally; they do not begin to run until the time arrives at which the suit could be prosecuted, and, while the corporation continues to be a going concern, no suit can be prosecuted by it against one of its shareholders to recover in respect of his stock subscription, until a call upon him has been made by the directors and payment thereof refused.

§ **2010. Where the Liability is that of a Partner,** the liability of the shareholder and that of the company are coordinate; the liability of each accrues at the time of the maturity of the debt or breach of the contract, for it is at this time that the creditor's cause of action accrues.[4] Thus, a statute of California provided as follows: "Each stockholder shall be individually and personally liable for his proportion of all the debts and liabilities of the company contracted or incurred during the time that he was a stockholder, for the recovery of which joint and several actions may be instituted and prosecuted." This statute, as we shall see,[5] has been held to create a liability similar to that of a partner or principal debtor. Under it the cause of action against the stockholder accrues at the same time that it accrues against the principal debtor; and, therefore, the

[1] Payne *v.* Bullard, 23 Miss. 88; *s. c.* 55 Am. Dec. 74; Curry *v.* Woodward, 53 Ala. 376.

[2] Payne *v.* Bullard, 23 Miss. 88; *s. c.* 55 Am. Dec. 74.

[3] McDonnell *v.* Alabama Gold Life Ins. Co., 85 Ala. 401; *s. c.* 5 South Rep. 120; Harmon *v.* Page, 62 Cal. 448; *s. c.* 9 Am. Corp. Cas. 29, 36; Barrick *v.* Gifford, 47 Oh. St. 180; *s. c.* 21 Am. St. Rep. 798. Where an insolvent corporation assigns all its property, including unpaid stock subscriptions, to trustees for the benefit of its creditors, and ceases to do business, the liability of stockholders upon their subscriptions becomes absolute at once, "or at least within a reasonable time thereafter," and the statute of limitations begins to run in their favor as against the trustee. Glenn *v.* Dorsheimer, 23 Fed. Rep. 695; *s. c.* 24 Fed. Rep. 536. In Missouri, the creditor's action against the stockholder may be brought at any time within the statutory limit after the maturity of the debt, though longer than that period after the dissolution of the corporation. McGinnis *v.* Kortkamp, 24 Mo. App. 378.

[4] Conklin *v.* Furman, 57 Barb. (N. Y.) 484.

[5] *Post*, § 3077.

statute begins to run from the date when the creditor could have brought his suit against the corporation.[1] A similar view, it will be remembered, has been taken of statutes of the same nature in New York,[2] and it is there held that the statute begins to run at the same time in favor of the shareholder as in favor of the corporation, — that is, when the debt is due, or the contract is broken.[3]

§ 2011. Where the Theory is that of Subrogation. — In another State where the view has been taken that the rights of the creditor may be worked out on the theory of *subrogation*, — that is, that the creditor may be subrogated to the rights of the corporation against its defaulting stockholder — yet it is held that the statute of limitations will bar his claim whenever it would bar that of the corporation.[4] A creditor's statutory cause of action, under the Missouri statute, directly against a stockholder of a dissolved corporation, to the extent of the latter's unpaid stock, accrues when his right to proceed against the corporation accrues.[5]

§ 2012. Rule in Iowa: Statute Begins to Run Simultaneously Against Corporation and Stockholder. — The Supreme Court of Iowa hold that an action by a judgment creditor of a corporation against one of its shareholders, to subject to the satisfaction of his judgment the indebtedness of such shareholder to the corporation in respect of his shares of stock, must be brought within five years from the time when the cause of action against the corporation accrued; and that it is not sufficient that it be brought within five years from the time when the creditor recovered his judgment against the corporation. The court say: "Without determining whether or not the creditor of a corporation can in any case maintain an action against a stockholder without first obtaining judgment against the corporation, we think there is nothing in the law making a stockholder liable to a creditor in such cases which in any manner enlarges the operation of the statute of lim-

[1] Davidson *v.* Rankin, 34 Cal. 503; Stilphen *v.* Ware, 45 Cal. 110; Conklin *v.* Furman, 48 N. Y. 527; affirming *s. c.* 8 Abb. Pr. (N. S.) 161; 57 Barb. (N. Y.) 484.

[2] *Post*, §§ 3079, 3780.

[3] Lindsay *v.* Hyatt, 4 Edw. Ch. (N. Y.) 97.

[4] South Carolina Man. Co. *v.* Bank, 6 Rich. Eq. (S. C.) 227.

[5] McGinnis *v.* Barnes, 23 Mo. App. 413; McGinnis *v.* Kortkamp, 24 Mo. App. 378.

itations, or affects any right which the stockholder has thereunder. If the theory of the plaintiff be correct, it would be within the power of a creditor of a corporation to extend the statutory law for a period which surely never was contemplated by the law-making power. In the case at bar the action upon the bonds might have been brought at any time within ten years after they became due. The issuance of execution, and demand for property to satisfy the same, could have been delayed for another period of ten or possibly twenty years, and an action brought against a stockholder five years thereafter. It is not the policy of the law to put it in the power of a party to thus extend statutory limitations. * * * In the case at bar the plaintiff recovered judgment against the corporation on the fourth day of June, 1878. It took no further action until July 22, 1880, when execution was issued and demand made upon the officers of the corporation for property upon which a levy could be made, and this action was not commenced until April 11, 1881. No cause for the delay is shown, and there can be no such excuse, because it was within the power of the plaintiff to have caused execution to issue at any time after June 4, 1878, and upon return thereof an action could have been commenced within five years. Affirmed."[1]

§ **2013. When his Liability is Secondary.** — But where, as in most cases, the liability of the shareholder is in the nature of a *guaranty*, secondary to that of the company, the law exacting as a condition precedent that the creditor shall exhaust his remedy against the company before he can attack the shareholder, obviously the statute does not begin to run until such period as, by an ineffectual prosecution of his claim against the corporation, or by the happening of some event which will excuse further proceedings against it, such as a dissolution or bankruptcy, the road is open for a direct proceeding against the stockholder. To illustrate: The cause of action against the stockholder, under a statute of Maine, was held not to accrue until a failure by a creditor to obtain the amount of his judgment from the corporate property by a due course of proceedings for that purpose.[2]

[1] First Nat. Bank of Garrettsville *v.* Greene, 64 Iowa, 448; *s. c.* 17 N. W. Rep. 86. The court refer to the following decisions where the statute received similar applications in other situations: Baker *v.* Johnson, 33 Iowa, 155; Prescott *v.* Gonser, 34 Iowa, 175, and in Beecher *v.* Clay Co., 52 Iowa, 140; *s. c.* 2 N. W. Rep. 1037; and in Hintrager *v.* Hennessy, 46 Iowa, 600.

[2] Longley *v.* Little, 26 Me. 162.

There are, however, confusing decisions on this subject.[1] Thus, under the statutes of New York, just adverted to, where the statute begins to run at the same time in favor of the stockholder and the corporation, it is necessary, before suing the stockholder, for the creditor to exhaust his remedy against the corporation by judgment, execution, and return of *nulla bona;* although the action against him is not upon the judgment, but on the original contract.[2] The Supreme Court of Vermont has held that the statute of six years, of that State, begins to run against a bill in equity by a creditor, for the purpose of calling in moneys due on account of unpaid stock, from the time of the accrual of the liability of the stockholder to pay such subscriptions, and of the corresponding right of the company to enforce their collection against the stockholder.[3]

§ **2014. Prescription under Code of Louisiana.** — An analogous rule has been declared, under the code of Louisiana, applicable to a proceeding by a creditor against a shareholder, in the nature of garnishment. The creditor could not succeed if more than ten years had elapsed since the maturity of the last installment due on the stock and before the commencement of the proceedings. The grounds on which the court proceeded in arriving at this result are thus given in its opinion, delivered by Rost, J.: "More than ten years had elapsed from the maturity of the last installment before the institution of these proceedings against him. Article 3508 of the Civil Code provides that all personal actions, except those enumerated in the title of the prescription, are prescribed by ten years if the creditor be present, and by twenty years if he be absent. The French text is: '*Toutes les actions personelles généralement quelconques.*' The disposition is as universal as language can make it. The directors of the company had their choice either to consider the stock as forfeited, on the non-payment of the installments at the periods fixed by the charter, or to sue for those installments. They neglected to act in the matter. Supposing this neglect to have originated in fraudulent motives on their part and that of the shareholders, the creditors of the company were not remediless; they might have caused the company to be administered, and the calls necessary to pay them to be made and enforced. The prescription which operates a release from debt does not require that the debtor

[1] *Post*, § 2015.

[2] Merritt *v.* Reid, 10 Daly (N. Y.), 311.

[3] Bassett *v.* St. Albans Hotel Co., 47 Vt. 313.

should produce any title, or that he should be in good faith. The neglect of the creditor alone operates the prescription. When he is present, and his silence has continued ten years, the law presumes payment; that presumption is *juris et de jure;* and the statement of the garnishee in this case that, according to his recollection, only the cash payment of $5 per share was made, will not avail against it.[1] Good faith not being required for this class of prescriptions, the relation which existed between the garnishee and the defendants can be no obstacle to it. It was formerly maintained by Dunod, and other civilians, that when there is in a contract reciprocal and synallagamatic conventions, as long as the contract is executed by one of the parties the other cannot refuse to execute it on his part, under the pretext of prescription, even if those conventions should be accidental. This was called the rule of correlatives. An attempt was made to have it inserted in the Napoleon Code, but it failed, and the rule forms no part of the law of prescription either in France or with us. We must hold, therefore, that the relations of parties under a contract or a charter do not affect the general law on this subject."[2] But the learned judge goes on to say that where no period is fixed for the payment of a balance due on a stock subscription, no prescription can accrue against a direct action by a creditor of the company.[3] This view is in conformity with that of the Supreme Court of Alabama, in a later case, where it is held that until a call is made, or there is an evident disbandment of the company and a relinquishment of business, the statute will not begin to run against a creditor.[4]

§ 2015. Where the Liability is in the Nature of a Guaranty of Payment. — Under a bank charter of Georgia, providing that the individual property of the stockholders should be bound for the ultimate redemption of the bills issued by the bank, in proportion to the number of shares held by them respectively, the Supreme Court of the United States has adopted the view that it was unnecessary first to exhaust the assets of the bank by legal proceedings before a right of action accrued to a bill-holder against a shareholder. The case was thought not to be so much like that of a guaranty of the *collection* of a debt, where a previous proceeding against the principal debtor is required, as like

[1] Citing Civil Code, arts. 3494, 3496.

[2] Brown *v.* Union Ins. Co., 3 La. An. 177, 182, citing 2 Troplong, Prescription, 534. See also Starke *v.* Burke, 9 La. An. 341.

[3] Brown *v.* Union Ins. Co., 3 La. An. 183.

[4] Curry *v.* Woodward, 53 Ala. 371, 376.

a guaranty of *payment*, where resort may be had at once to the guarantor without a previous proceeding against the principal.[1] The court reasoned that a judgment and execution unsatisfied are merely *evidence* of insolvency and inability to collect. The fact might be established as well by other evidence; among other modes, by an assignment and continued suspension of business, or other notorious indications.[2] The court, therefore, concluded that the liability for the "ultimate redemption of the bills, if properly enforced, arose when the bank refused or ceased to redeem, and was notoriously and continuously insolvent."[3]

§ 2016. In Case of Liability for Mismanagement or Delinquency. — Under a statute providing that "if any loss or deficiency of the capital stock in any bank shall arise from the official mismanagement of the directors, the stockholders at the time of such mismanagement shall, in their individual capacities, be liable to pay the same,"[4] it has been held that the statute begins to run from the *time of the happening of the loss* or deficiency in respect of which the liability is created. The court, speaking through Wilde, J., said: "It was then argued by the plaintiff's counsel that the statute did not begin to run until the plaintiff's right to sue in equity accrued, which was not before the receivers of the bank refused to commence an action for their benefit. But, if this argument would hold good, the plaintiffs might delay their application to the directors of the bank, or the receivers, for any length of time, and the statute would be inoperative and nugatory. It has also been argued that the statute did not begin to run until it was first ascertained what would be paid by the assets of the bank. But we think that suits might be commenced against the bank and against the stockholders at the same time, and that the suits might go on *pari passu*. But there is another and a conclusive answer to both of these arguments. The demand sought to be enforced in this suit was a debt alleged to be due to the bank. Whenever, therefore, the

[1] See on this point, Morris *v.* Wadsworth, 11 Wend. (N. Y.) 100; *s. c.* 17 Wend. (N. Y.) 103; 2 Pars. on Notes & Bills, 142, 143; Brandt on Suretyship, §§ 169, 170.

[2] See on this point, Camden *v.* Doremus, 3 How. (U. S.) 533; Reynolds *v.* Douglass, 12 Pet. (U. S.) 497; 2 Am. Ld. Cas. 134; *post*, Ch. 59.

[3] Terry *v.* Tubman, 92 U. S. 156, opinion by Mr. Justice Hunt.

[4] Rev. Stat. Mass. 1836, ch. 36, § 30.

bank became insolvent by the loss of its capital stock, an action accrued to the bank, according to the construction of the 30th section, which is contended for by the plaintiff's counsel, to recover a sum from the stockholders, respectively, equal to each one's share of the stock. The statute, therefore, began to run, in strictness, immediately on the loss of the capital stock, and certainly when the bank stopped payment; and after the lapse of six years from that time the debt was barred, and as effectually as though it had been actually paid. So, also if after the insolvency of the bank the stockholders became directly liable to the creditors, the plaintiff's right of action accrued immediately upon the loss of the whole capital stock, and the statute of limitations is a bar to the plaintiff's demand in any form of action."[1]

§ 2017. In Favor of One who has Transferred his Shares.— Suppose the governing statute or constitution of a company makes a retiring shareholder liable for his proportion of the losses of the company incurred up to the time of his ceasing to be a shareholder, when does the statute of limitations begin to run in his favor? At the time when the company became liable to pay the debt, or at the time when he ceased to be a member? An English vice-chancellor has held that the statute begins to run from the time when he transferred his shares, in respect of any loss of the company accruing prior to that time, although the amount of the liability may not have been ascertained until long afterwards.[2]

§ 2018. In Case of Renewals.— The discounting of a new note and the application of the proceeds realized from it to the

[1] Baker *v.* Atlas Bank, 9 Metc. (Mass.) 182, 197.

[2] Helby's Case, L. R. 2 Eq. 167. It was held by the House of Lords, in 1866, reversing Lord Chancellor Westbury (33 L. J. (Bank.) 26), that liability to debts of a joint-stock company, incurred in 1849, by a person then becoming a shareholder of the company and signing the deed of settlement, which expressly created that liability, made him a debtor at the moment the debts were contracted by the company; hence calls on him made in 1862 and 1863, under the authority of a winding-up order, to pay money in respect of those debts, did not themselves constitute "a debt contracted after the passing of the act, 1861," but amounted merely to an enforcement of the liability incurred when he became a shareholder. Williams *v.* Harding, L. R. 1 H. L. 9.

payment of a former note extinguishes the old debt and creates a new one. Such a transaction is not a mere change of securities,— the taking of a new note in the place of the old one, — but a discount and a payment of money upon the strength of the new security, by means of which the old obligation is discharged, given up, and surrendered, so as to render it ineffective, for any purpose. Under such circumstances, the contract does not relate back to the time when the first note was discounted; but, the old one having been paid and taken up, the debt will be deemed to have been contracted when the new note was given. If these premises are correct, it follows that if a debt thus contracted by a manufacturing corporation by the giving of a new note is payable within one year after the date of such new note, and a suit is brought on the note against the company within one year after the same becomes due, the stockholders are personally liable.[1] The contrary has, however, been held by the New York Court of Appeals, construing a statute of that State relating to manufacturing corporations.[2] That court reasoned that the taking, by a creditor of his debtor's note for an existing indebtedness, does not merge or extinguish the indebtedness, but that the note is merely evidence of it, and its operation is only to extend the time of payment.[3] The court, therefore, held that the provision of the statute that no stockholder shall be personally liable for a debt of such a corporation unless a suit for the collection of it shall be brought against it *within one year after it became due*, requires that the suit against the stockholder, to charge him with the debt of the corporation evidenced by a note which has been thus renewed, must be brought within one year after the first note fell due. The court, speaking through Folger, J., reason thus upon the question of the effect of the renewals: "It is claimed, that the raising of money on the second or later note, and using it to take up the first or former one, is a pay-

[1] Fisher *v.* Marvin, 47 Barb. (N. Y.) 159.

[2] N. Y. Laws, 1848, ch. 40, § 24.

[3] The court cite the following cases, as affirming, more or less directly, this principle: Garrison *v.* Howe, 17 N. Y. 458, 465; Deming *v.* Puleston, 55 N. Y. 655; *s. c.* 14 Am. Rep. 342; aff'g *s. c.* 3 Jones & Sp. 309; Boughton *v.* Otis, 21 N. Y. 261, 265; Jones *v.* Barlow, 62 *Id.* 202. See also National Bank *v.* Bigler, 83 N. Y. 59; City Nat. Bank *v.* Phelps, 86 *Id.* 491.

ment of it. If there had been the discharge of the plaintiff from further liability by reason of its indorsement of the first note, or if by the transaction it had obtained a claim against another party, there would be more plausibility in the position. In fact, the plaintiff never gets by the operations with the successive notes, any satisfaction of its original claim. It has got discounted the note of its debtor, but it is liable to pay it when due if the debtor does not pay. It does pay it when due, by the avails of another like discounting. It has the use of money, by using its credit and incurring liability. It has never yet received compensation for the property it sold. The cases cited to the contrary, are where notes with other parties have been discounted, and the avails applied to the payment of notes with different names upon them.[1] The bank, indeed, which discounted the first or any other note, could have held it as a new liability, and enforced it, irrespective of the original indebtedness. It is enough to say that it did not. It looked to the plaintiff for the money to take up the discounted note. The plaintiff paid it, and received back again the unredeemed promise of the primary debtor. Indeed, the fallacy that runs through the whole argument is, that a promise to pay is payment, because it is put in writing in the form of a promissory note instead of being oral, and the note used as a means of borrowing money. Until the promise is in fact redeemed, there is no payment. Until payment, there is no satisfaction of the indebtedness for the goods sold."[2] The decision does not seem to be tenable upon any intelligent theory. However the question of the effect of a renewal may stand with reference to other questions, such as preserving existing securities, the defense of usury, or the like,— so far as the statute of limitations is concerned, every renewal is a *new promise*, especially where a previous written contract is surrendered and a new one substituted in its place. If this theory is correct, whenever debtor and creditor meet and renew a note, they shorten the period of limitation, which runs from the maturity of the first note; and if

[1] Bank of Salina *v.* Babcock, 21 Wend. 501.

[2] Jagger Iron Co. *v.* Walker, 76 N. Y. 521, 525–6; *s. c.* 19 Am. & Eng. Corp Cas. 379, n.; re-affirmed in Hardman *v.* Sage, 124 N. Y. 25; *s. c.* 35 N. Y. St. Rep. 54; 26 N. E. Rep. 230; affirming 47 Hun (N. Y.), 230.

they renew it often enough, they bar it by limitation by their concurrent act, although their purpose is to keep it alive. So, under this theory, if a bank accommodates a manufacturing corporation, so far as to grant extensions of its notes to the extent of more than a year after the maturity of the first one, it accommodates the debt out of existence, so far as any recourse upon the stockholders is concerned. And yet, as elsewhere seen, the theory of the courts of that State is that the stockholders under that statute are liable as *partners*. The artificial body called the corporation is merely their shadow or representative. They are the substantial debtors. They are the ones who are obliged by the accommodation; and by obliging them and taking a new promise from their *alter ego* the corporation, the bank destroys the obligation as a debt against them, as much as though they were mere sureties not consenting to an extension. So, in California, where renewal notes are given by a corporation, the statute of limitations begins to run in favor of the stockholders from the maturity of the first notes, and an action against the stockholders is barred in three years from the time the first notes matured under a statute [1] which prescribes that actions against the stockholders of a corporation must be brought within three years after the discovery of the facts on which the liability was created.[2]

§ **2019. In Case of Bank Bills and Bank Debts.**—It is well settled that statutes of limitation have no application to bank-bills, *circulating as money*.[3] The reason of the rule, as stated by Lord Mansfield, and often reiterated, is "that these notes are not like bills of exchange, mere securities or documents for debts, nor are they so esteemed; but are treated as money in the ordinary course and transactions of business, by the general consent of mankind." [4] Moreover, their date is no evidence of the time when they were issued, since they are being continually returned to the bank and re-issued by it.[5] So long as they continue to circulate as money, it would be, therefore, impossible to fix upon a

[1] Cal. Code Civ. Proc., §§ 338, subd. 1, 359.

[2] Hyman *v.* Coleman, 82 Cal. 650; *s. c.* 23 Pac. Rep. 62.

[3] Miller *v.* Race, 1 Burr. 457; Dougherty *v.* Western Bank of Georgia, 13 Ga. 287; Bethune *v.* Dougherty, 30 Ga. 770; Kimbro *v.* Bank of Fulton, 49 Ga. 419.

[4] Miller *v.* Race, 1 Burr. 457.

[5] Hepburn *v.* Commissioners, 4 La. An. 87.

time for the statute to begin to run.[1] But if the notes have ceased to circulate as currency, have ceased to be taken in and received by the bank, and have ceased to be considered as money in the ordinary sense of that term, then the reason for the rule ceases, and with it the rule itself. They no longer have a distinctive character, as compared with other contracts, such as exempts them from the operation of statutes of limitation.[2] Applying this doctrine, the Supreme Court of the United States has held, under a Georgia bank charter which provided that the individual property of the stockholders should be bound for the ultimate redemption of the bills, in proportion to the number of the shares held by them respectively, that the liability of the stockholders commenced, not when the assets of the bank had been administered under an assignment law, nor after demand of payment of the particular bills and refusal, but when the bank refused or ceased to redeem its circulation generally, and was notoriously and continuously insolvent.[3] In the case of *ordinary debts* of insolvent banks in North Carolina, the statute runs against the right to enforce, by action, the personal liability of stockholders from the time of the *suspension of specie*

[1] Dougherty *v.* Western Bank of Georgia, 13 Ga. 287, 299; Kimbro *v.* Bank of Fulton, 49 Ga. 419, 421. "How," said Nesbit, J., in the former case, "can a limitation be applied to that which, without much perversion of truth, may be said to be like *Melchisedec*, — without beginning of days or end of life? It has no beginning on its face, for its date is no evidence of the time when it was issued. It may bear date to-day and may be issued to-morrow, or next year; or it may be issued to-day and returned to-morrow, and re-issued the next day. Or it may not be issued at all until after it is barred by time, commencing to run from its date. If it could be barred at all it would seem that the starting-point of the statute ought to be the time of its issue. And how shall the world so know that as to exercise a necessary diligence by suing within time? Nor has it an end of life, because it is never overdue. If, as Judge Story says, it is never overdue no matter when issued or how often re-issued, but is always an immature representative of a legal tender, when shall the statute commence to run? Shall it be said, from the time of a demand and refusal to redeem? If so, then an insolvent bank, by which I mean a bank which is unable to redeem its bills, is upon a better footing than one whose credit is good, — that is to say, the former is protected by the statute, and the latter is not." Dougherty *v.* Western Bank of Georgia, 13 Ga. 287, 299.

[2] Kimbro *v.* Bank of Fulton, 49 Ga. 419; Terry *v.* Tubman, 92 U. S. 156.

[3] Terry *v.* Tubman, 92 U. S. 156.

payments by the bank.[1] In California, the right of action against a commercial bank and its stockholders accrues when the bank stops payment. The statute then begins to run against both.[2]

§ 2020. Effect of the Lien of the Corporation on the Debtor's Shares. — According to a decision in Louisiana, the stock of an incorporated bank issued in the name of a subscriber who is indebted to the bank by note, under a previous by-law entitling the bank to a *lien on stock* for notes of the owner, and retained by the bank, is deemed to be held in *pledge* for the note, equally as if the debtor had delivered it in pledge. This pledge will prevent the running of the statute of limitations upon the note. And one who may acquire a subsequent lien on or interest in the stock has no better right than the debtor to raise the objection that the time for suing the note is barred, and the prior lien of the bank thereby extinguished. The pledge to the bank preserves their right of action.[3]

§ 2021. Fraudulent Concealments of the Cause of Action. — A fraudulent concealment of the cause of action will take a case out of the statute of limitations.[4] On this principle, where the general banking law of Connecticut imposed upon the stockholders of banks which should be organized under it, an individual liability to double the amount of their stock, while they continued stockholders, and one year thereafter, and P., a creditor of the bank, made demand of S., a stockholder for the payment of his debt, the bank being insolvent, and S. requested delay, promising not to transfer, but did secretly and fraudulently transfer it, — it was held, in a suit commenced more than one year after such transfer, that the statute was inoperative against P.[5] But a mere *non-user* of all corporate powers is not a concealment of the cause of action such as suspends the running of the statute of limitations.[6]

[1] Long *v.* Yanceyville Bank, 90 N. C. 405.

[2] Mitchell *v.* Beckman, 64 Cal. 117.

[3] West Baton Rouge *v.* Duralde, 22 La. An. 107. Compare Paine *v.* Stewart, 33 Conn. 516.

[4] Bailey *v.* Glover, 21 Wall. (U. S.) 342, 348; note, 60 Am. Dec. 511.

[5] Paine *v.* Stewart, 33 Conn. 516.

[6] Fort Scott *v.* Scholenberg, 22 Kan. 648.

§ 2022. In Favor of Corporation Where it has Forfeited the Shares of a Member..— Where a corporation forfeits the stock of a shareholder for failure to pay assessments, and the shareholder proceeds against the company by *mandamus* to compel it to issue to him certificates for his shares, the statute of limitations does not begin to run in favor of the company until the day when they declare the forfeiture. Prior to this time, a trust relation is deemed to have existed between the shareholder and the company, which prevented the running of the statute.[1]

§ 2023. In Favor of Executors and Administrators.—Where a stockholder dies and his estate passes into the hands of an executor or administrator, short statutes of limitation, which exist in all American jurisdictions, prescribing the period within which demands must be presented against estates of deceased persons, and enacting that demands not so presented shall be forever barred,— will often intervene to cut off the remedy of the creditor unless prompt action is taken. Such a statute of limitation, in the Probate Court of California, barred the demand of a creditor of a corporation, against the estate of a deceased stockholder, in *ten months* after the publication of the grant of letters testamentary, where the cause of action had accrued against the testator in his life-time.[2] By the probate law of Missouri, this period of limitation is fixed at *two years;* and if the corporation is dissolved it begins to run from the date of publication of notice of the grant of letters. The theory is that "the claim of the creditors of a dissolved corporation against its stockholders, for unpaid stock, passes, by the fact of the dissolution of the corporation from a secondary to a primary liability; so that, if the corporation is dissolved when the publication of the grant of letters is made, the statute immediately begins to run."[3] And where the corporation became dissolved pending the administration of the estate of the deceased stockholder, and no call had ever been made against him or his

[1] Rice *v.* Pacific Railroad, 55 Mo. 146.

[2] Davidson *v.* Rankin, 34 Cal. 503.

[3] Garesche *v.* Lewis, 15 Mo. App. 565; *s. c.* aff'd, 93 Mo. 197; 6 S. E. Rep. 54; 11 West. Rep. 906. Compare Ambs *v.* Caspari, 13 Mo. App. 587; Spaulding *v.* Suss, 4 Mo. App. 541.

executor for what remained unpaid in respect of his shares, — it was held that an action could not be maintained by a creditor of the corporation against the executor of the deceased shareholder after the final settlement of the decedent's estate.[1]

§ 2024. From Date of Judgment against Corporation. — Under other statutes in force, the statute of limitations does not begin to run against an action to enforce against a stockholder the payment of a *judgment* obtained against the corporation, until the entry of judgment, in the absence of a call made by the corporation on the stockholder, or some other definite act which puts him in an adverse position toward the corporation and hence sets the statute in motion.[2]

§ 2025. In Special Cases.— The statute of Nebraska,[3] which makes stockholders in a corporation liable for debts contracted by the corporation while its officers are in default in publishing an annual notice stating "the amount of all the existing debts of the corporation," does not impose a penalty, its purpose being to secure the rights of creditors, and an action to recover such debts is not barred in one year, under Code Civ. Proc. Neb., § 13, limiting actions to recover penalties for forfeitures.[4] - - - - A statute under which a corporation was formed, provided that the capital stock should be paid in, in two years, or the corporation be dissolved. F. subscribed for stock, agreeing to pay in weekly installments, the payments to cover a period of more than two years. In an action against him to recover unpaid installments, which action would be barred by the statute of limitations if it could be considered that the statute began to run at the expiration of two years after the formation of the corporation, it was held that the statute did not run from that time, and that the action was not barred.[5] - - - - Under a statute providing that no suit shall be brought against stockholders for a corporate debt until execution has been returned unsatisfied upon the property of the corporation, the time of accruing of the cause of action, and the time when the statute of limitations begins to run, is the return of the execution at the end

[1] Larkin *v.* Willi, 12 Mo. App. 135.

[2] Powell *v.* Oregonian R. Co., 38 Fed. Rep. 187; *s. c.* Powell *v.* Oregonian R. Co., 13 Sawy. (U. S.) 535; 3 L. R. A. 201; 6 Rail. & Corp. L. J. 28. See also Manning *v.* Hayden, 5 Sawy. (U. S.) 379.

[3] 31 Comp. Stat. Neb. c. 16, § 136.

[4] Howell *v.* Roberts, 29 Neb. 483; *s. c.* 45 N. W. Rep. 923.

[5] Frank *v.* Morrison, 55 Md. 300.

of the sixty days allowed the sheriff for making such return, or in case he fails to make it, on the lapse of a reasonable time for proceedings by the creditor to procure the return.[1]

Article III. Questions Under Special Statutes.

§ **2028. Limitation as to Time when Suit shall be Brought against Corporation.** — If a creditor could delay suing the corporation until the period of the statute of limitations relating to his demand had nearly run, and could then, perhaps after a tedious litigation against the corporation, secure a judgment in consequence of which he would be entitled to a new lease of time as against the shareholders, in effect subjecting them to the operation of a double statute of limitations, the inconveniences which would arise in some instances would be great. With the view, it seems, of obviating this, the legislatures of several States have enacted statutes like the following: "No stockholder shall be personally liable for the payment of any debt contracted by any company * * * which is not to be paid within one year from the time the debt is contracted, nor (unless a suit for such debt shall be brought against such company) within one year after the debt shall become due."[2] By analogy to the rule which obtains in the interpretation of the statute of frauds,[3] this statute has been held not to apply to a demand which may accrue at any time, and which, therefore, may be enforced within one year, — such as a claim for a breach of warranty of title in a sale of chattels.[4] But it has been held that a contract by a corporation to indemnify an agent for pur-

[1] Mills *v.* Hicks, 44 N. Y. Super. 527.

[2] 1 Wag. Stat. Mo. 336, § 13; R. S. 1879, § 939; 1889, § 2781.

[3] See Foster *v.* McO'Blenis, 18 Mo. 88.

[4] Dryden *v.* Kellogg, 2 Mo. App. 87.

chasing certain real estate for it was a contract not to be performed within one year from the time the debt was contracted, and within the statute; and therefore stockholders could not be charged in consequence of it.[1] A similar statute in New York has been held to apply to a debt due upon a contract of hiring at a stated sum per year, payable in monthly or quarterly installments, where the period of service was indefinite and could be terminated by either party at pleasure. The most that the defendant could claim in such a case was that the statute commenced to run from the expiration of each year. If, therefore, any of the wages which constituted the cause of action fell due on the 31st of December of a given year, and suit was not brought within a year thereafter, they would be barred by the statute; but the statute would not apply to such installments as fell due within a year prior to the commencement of the action.[2]

§ **2029. Continued.**—It is not necessary, in the view of the Missouri courts, in order to obviate the bar of this statute, to bring suit against the corporation on the demand within one year after it became due, where the *bankruptcy* or *dissolution* of the corporation renders such a suit a vain proceeding;[3] but the Supreme Court of Illinois has taken the opposite view,[4] and, it seems, upon reasons which are not without support in the authorities; for it is a familiar rule in the administration of statutes of limitation that, unless the legislature has made a given exception to such a statute, the courts cannot make it.[5] The Missouri statute above quoted has been held to apply so as to bar the summary remedy by *motion*, given by another statute even as respects unpaid subscriptions, unless the creditor brought his suit against the company on which his judgment was obtained within one year after the debt became due; but whether the creditor might not have a remedy in equity against a stock-

1 Cox *v.* Gould, 4 Blatchf. (U. S.) 341.

2 Hovey *v.* Ten Broeck, 3 Rob. (N. Y.) 316.

3 Hovey *v.* Ten Broeck, 3 Rob. (N. Y.) 316; State Savings Assn. *v.* Kellogg, 52 Mo. 583; Dryden *v.* Kellogg, 2 Mo. App. 87.

4 Tarbell *v.* Page, 24 Ill. 46. It was here held that the fact that the company was insolvent did not excuse the bringing of suit against it within the year.

5 See Ang. on Lim. (6th ed.), §§ 23, 29, 485, 487, 488, and authorities there cited.

holder to enforce payment of his stock, to which the statute would not be applicable, the court left undetermined.[1] Where the plaintiff brought suit against the corporation, on the debt, in one of the courts of the State within a year, and took a *nonsuit*, and within a year thereafter, but more than a year after his debt fell due, brought a new suit in the Federal court and recovered judgment, it was held that he was barred, by lapse of time, of the right to enforce a summary personal liability on the part of stockholders.[2]

§ **2030. Continued.**— The peculiarity of these statutes seems to be that although the plaintiff's demand may have been reduced to judgment against the corporation, yet this judgment will not entitle him to proceed against the stockholder unless the suit upon which it was founded was commenced within a year from the time the debt of the corporation to him fell due.[3] The condition precedent, it will be seen, does not necessarily require that suit against the corporation should have proceeded to judgment. It is the bringing of the suit against the corporation within the period named that gives the creditor the right to proceed against the stockholder. This being a material fact, essential to his recovery, he must, in a suit against a stockholder, aver its performance, in his declaration or petition, or it will be obnoxious to a demurrer.[4] If, as the Missouri courts hold,[5] and the Illinois court, in one particular, denies,[6] circumstances may intervene which will excuse the bringing of suit against the corporation, by a parity of reasoning it would seem necessary to aver the existence of such circumstances, in order to excuse the bringing of suit. Such a statute has, however, in New York been construed as requiring the recovery of a judgment and the return of execution unsatisfied in the suit thus brought against the corporation by the creditor. Hence, as there held, in an action against stockholders the complaint must allege judgment against the corporation unsatisfied; it is not sufficient to allege, in accordance with

[1] Haskins *v.* Harding, 2 Dill. (U. S.) 99, 106.

[2] *Ibid.*

[3] Haskins *v.* Harding, 2 Dill. (U. S.) 99.

[4] Tarbell *v.* Page, 24 Ill, 47.

[5] State Savings Assn. *v.* Kellogg, 52 Mo. 583; Dryden *v.* Kellogg, 2 Mo. App. 87, 95.

[6] Tarbell *v.* Page, 24 Ill. 47. So held in Birmingham National Bank *v.* Mosser, 14 Hun (N. Y.), 605.

the terms of the statute, that a suit for the collection of the debt was brought against the company within one year after the debt became due.[1]

§ 2031. Statute of Maine as to Past Members. — It remains to consider briefly the construction placed upon certain special statutes of limitation relating to this subject. A statute of Maine, after declaring the liability of shareholders to the creditors of the corporation, continues: "And such liability shall continue, notwithstanding any subsequent transfer of such stock, for the term of one year after the record of the transfer thereof on the books of the corporation, and for the term of six months after judgment recovered against such corporation in any suit commenced within the year aforesaid."[2] The object of the legislature, in passing this statute, was to check the abuse of solvent shareholders escaping liability by transferring their shares when they discovered that the corporation was *in extremis*. It was founded in the same policy as the similar provision of the English Companies Act, 1862, not here considered.[3] It was not, therefore, construed as a general statute of limitation, nor did it refer to a stockholder who had never parted with his stock, but only to those whose stock had been transferred, and the transfer recorded;[4] nor was the nature of this limitation changed by the statute of 1844, chapter 109.[5]

§ 2032. Statute of Maine of Six Months. — Under the Revised Statutes of Maine[6] it is provided: "At any time within six months after the return of an execution against a corporation, recovered on a debt for which any stockholder is liable under the preceding section, unsatisfied in whole or in part, for want of attachable property of the corporation, the plaintiff in such execution may make demand of any stockholder of such corporation to disclose and show to the officer having such execution attachable property of such corporation sufficient to satisfy the execution." And, further:[7] "After demand as aforesaid, the execution creditor may have an action on the case against such

[1] Lindsley *v.* Simmonds, 2 Abb. Pr. (N. S.) 69.

[2] Rev. Stat. Me. 1840, ch. 76, § 18.

[3] See Lind. Comp. L., 5th ed., p. 820.

[4] Ingalls *v.* Cole, 47 Me. 530.

[5] *Ibid.*

[6] Rev. Stat. 1857, ch. 46, § 25.

[7] *Ibid*, § 26.

stockholder, to recover of him individually the amount of his execution and costs, or the deficiency thereof, not exceeding the amount for which said stockholder is liable by section twenty-four. Such action must be commenced within six months after the date of the rendition of judgment against the corporation." In a case arising under these provisions the proper procedure was stated to be: 1. That the officer holding the creditor's execution against the corporation make a return thereon that it is unsatisfied, in whole or in part, for want of attachable property of the corporation. 2. That *after* the return of such execution, and *before* the expiration of six months after the date of the rendition of judgment against the corporation, notwithstanding the six months guaranteed by section twenty-five, the creditor make demand of the stockholder to disclose and show to the officer having such execution attachable property of such corporation sufficient to satisfy the execution. 3. That after such demand, and within six months after the date of the rendition of judgment against the corporation, the creditor sue the stockholder in case. The time within which demand may be made begins to run from the return of the officer upon the execution, and not from the return day thereof.[1]

§ 2033. Statute of New York Touching Demands of Purely Equitable Cognizance. — By a statute of New York, the time for commencing suits in the courts of chancery was expressly limited, in cases of a concurrent remedy at law, to the time allowed for bringing actions in a court of law; and in all other cases, of exclusive cognizance in equity, to ten years.[2] The demand of the creditor of a corporation against a shareholder was not of a purely equitable character, since an action at law would lie upon it; it was, therefore, subject to the statute of six years.[3] But an action by the receiver of a corporation, to charge the defendants as trustees of the corporation, with the fraudulent diversion of the corporate property, is an equitable action, "the limitation of which is not specially prescribed," within the meaning of Code Civ. Proc. N. Y., § 388, providing that such actions must be brought within ten years.[4]

[1] Lovegrove *v.* Brown, 60 Me. 592. See also Cummings *v.* Maxwell, 45 Me. 190.

[2] 1 Rev. Stat. N. Y. 1830, p. 301, §§ 49-52.

[3] Lindsay *v.* Hyatt, 4 Edw. Ch. 97.

[4] Pierson *v.* Morgan, 20 Abb. New Cas. 428; *s. c.* affirmed 4 N. Y. Supp. 898; 17 Civ. Proc. Rep. 124.

TITLE FOUR. SHARES CONSIDERED AS PROPERTY.

CHAPTER XXXIII.

POWERS OF THE CORPORATION IN RELATION TO ITS OWN SHARES.

§ **2040. Principles Governing the Distribution of Stock.**— In the first place, it is to be observed that a joint-stock corporation may have a legal existence before any shares have been issued and distributed,—as where there is no statute making the incorporation of the company dependent upon the subscription of its stock and the payment therefor, but there is a proviso that the corporate existence shall date from the filing of its charter in the office of the secretary of state, and, by another statute the charter so filed is required to state only the amount of the capital and the number of shares into which it is divided.[1] In the next place, after the corporation has been regularly organized, it acquires an inherent right to admit new members; and where a corporation is organized under a charter granted to certain individuals "and their associates," the right, after an organization has been effected, to admit new members, is not confined to the original charter members, but extends also to those who become members by participating in the organization.[2] In the third place, where the corporation possesses a joint stock, and a part of its authorized capital stock remains untaken at the time of its incorporation, the right to issue the remainder of it is a corporate franchise, held by the corporation in trust for the corporators, and it must be disposed of for the *equal benefit* of all. And it has been held that if the directors dispose of it to the corporators unequally, and in violation of the rights of any, each corporator injured by their act may have his remedy in assumpsit against the corporation.[3] And where a board of directors was elected by means of votes represented by shares so illegally issued, an injunction was granted restraining them from taking possession of the corporate property or assuming to act as directors.[4] Moreover, it has been held that a resolution of the directors, carried into effect, distributing such shares of stock among all the stockholders who are not in arrears on the shares already taken by them, and excluding those who are, is an unlawful imposition of a penalty on those in arrears, and a violation

[1] National Bank *v.* Tex. Investment Co., 74 Tex. 421; *s. c.* 12 S. W. Rep. 101.

[2] State *v.* Sibley, 25 Minn. 387.

[3] Reese *v.* Bank of Montgomery Co., 31 Pa. St. 78; *s. c.* 72 Am. Dec. 726.

[4] Humboldt Driving Park Asso. *v.* Stevens, 34 Neb. 528; *s. c.* 52 N. W. Rep. 568.

of the equal rights of a corporator who was ready and offered to take his proportion of the new shares.[1] But where the original corporators, to whom the charter is granted, stand ready to subscribe for more shares than the amount authorized, and, in the scramble for precedence, the total amount is subscribed for by some of them while others are ignored, the latter, according to one doubtful holding, have no remedy against the company, in the absence of fraud or bad faith.[2] But it would seem to be, in its very nature, illegal and oppressive for some of the co-adventurers to whom the franchise has been granted, to shut out the others from participating in the enterprise after the legislative grant has been procured.[3]

§ **2041. Legal Requisites of a Valid Issue of Stock.**— It is essential to the validity of corporate stock that the conditions of its issue should substantially conform to the requirements of the charter or governing statutes. Thus, under a provision in the charter "that the president and directors shall cause a written or printed certificate to be given to each shareholder for every share by him subscribed, signed by the president and directors, and countersigned by the treasurer; which certificates shall be transferable by an assignment made thereof on the books of the company by the owner in person or by an attorney in fact," the court held that certificates signed by the president and countersigned by the treasurer, and delivered to one who never subscribed for such stock, and without consideration, and without being entered on the books, were void; and when afterwards transferred, not on the books of the company, to one for a valuable consideration, still conveyed no stock, as they were issued by the president alone, and to one who was never a subscriber, and, therefore, issued without authority.[4] And so, an instrument whereby the president and manager of a corporation, — as such, agrees to "refund"

[1] Reese *v.* Bank of Montgomery Co., 31 Pa. St. 78; *s. c.* 72 Am. Dec. 726.

[2] Brown *v.* Florida Southern Ry. Co., 19 Fla. 472.

[3] In Massachusetts a stockholder who has taken his proportion of new shares of stock in a corporation, issued under stat. 1877, ch. 230, Sec. 3, is deprived of any right to a *premium* obtained on a sale thereof pursuant to a vote of the stockholders, unless the vote in terms so provides. Mason *v.* Davol Mills, 132 Mass. 76.

[4] Holbrook *v.* Fauquier &c. Turnpike Co., 3 Cr. C. C. (U. S.) 425.

to a person named a specified sum at one year's notice, and which provides that "this money shall draw what interest it makes in proportion to all shares in the institution," — is not a certificate of stock, but an obligation of the corporation upon which the holder can maintain an action against a stockholder.[1]

§ **2042. Special Stock in Massachusetts.**— In Massachusetts, in addition to the usual classes of common and preferred stock, the law authorizes a third kind, called "special stock," the characteristics of which are that it is limited in amount to two-fifths of the actual capital; that it is subject to redemption by the corporation at par, after a fixed time to be expressed in the certificates; that the corporation is bound to pay a fixed half-yearly sum, or dividend upon it, as a debt; that the holders of it are in no event liable for the debts of the corporation beyond their stock; and that the issue of the special stock makes all the general stockholders liable for all debts and contracts of the corporation until the special stock is fully redeemed.[2] Such special stock can only be issued by a vote of three-fourths of the general stockholders at a meeting duly called for the purpose.[3] Under these statutes, it was held that both the proper notification of the meeting and the three-fourth vote of the general stockholders are essential to the validity of such stock; that a vote to issue "special stock" at a meeting, called to consider whether the corporation will issue "preferred stock" is invalid; and that a vote to issue "special stock" is equally invalid, though passed at a meeting duly held for that purpose, if the record of the meeting fails to show that three-fourths of the general stockholders voted for such issue.[4]

§ **2043. Right of the Holder of a Certificate, under an Invalid Issue of Stock, to Rescind.** — Where the issue of shares is illegal for the want of power of the company to issue them, where the shares cannot legally exist, the person taking them cannot, by estoppel or otherwise, become a member in respect to them. Hence, being open to repudiation by the corporation itself, or by dissenting stockholders, the person taking them has a right to rescind the contract under which the stock

[1] Jones *v.* Woolley, 2 Ida. 790; *s. c.* Pac. Rep. 120.

[2] Stats. Mass. 1855, c. 290; 1870, c. 224, §§ 25, 39, cl. 4; Pub. St. Mass., c. 106, §§ 42, 61, cl. 3; Williams *v.* Parker, 136 Mass. 204, 207.

[3] Mass. St. 1870, c. 224, § 25.

[4] American Tube Works *v.* Boston Machine Co., 139 Mass. 5; *s. c.* 29 N. E. Rep. 63.

was taken and be restored to his original position. Where a corporation illegally issued stock to a creditor, and paid him successive dividends, and failed at two meetings to cure the illegal issue, a notice of rescission by the creditor twenty-seven months after the first issue of stock, offering to return the shares, tendering the dividends, and demanding a redelivery of the considerations given by him, was exercised in sufficient time to entitle him to prove his claim against the insolvent estate of the corporation.[1]

§ 2044. Lost Certificate of Stock — Issue of New One. — Where a corporation upon the presentation of a certificate of stock by the holder, refuses to transfer upon its books the shares represented by it, to the person in whose name as transferee, the power of attorney indorsed thereon, has been filled out, it incurs a liability to an action for damages.[2] If, therefore, on the representation of the person to whom the certificate was originally issued, that it has been lost or destroyed, it issues him another certificate, and he negotiates it to an innocent taker, the company incurs the risk of double liability in respect of the same shares; for in such a case the company must make good the loss to a *bona fide* transferee of the original shares.[3] What then are the rights of the holder of a certificate of stock which has been lost? Can he compel the company to issue him another certificate of the same shares? There is no doubt that the company may refuse to do so until it has received satisfactory indemnity against the risk it thereby incurs. That it may exact a suitable *bond of indemnity* against the risk it runs in doing so is certain.[4] But even when the company has been adequately indemnified, grave reasons suggest themselves why a court of equity should hesitate to take such action. To compel a corporation to issue a second original certificate in the place of the one alleged to

[1] American Tube Works *v.* Boston Machine Co., 139 Mass. 5; *s. c.* 29 N. E. Rep. 63.

[2] *Post*, § 2447, *et seq.*

[3] Greenleaf *v.* Luddington, 15 Wis. 558; *s. c.* 82 Am. Dec. 698; Cleveland &c. R. Co. *v.* Robbins, 35 Ohio St. 483.

[4] Guilford *v.* Western Union Tel. Co., 43 Minn. 434; *s. c.* 46 N. W. Rep. 70; Galveston City Co. *v.* Sibley, 56 Tex. 269. Compare Savannah Nat. Bank *v.* Haskins, 101 Mass. 370; Chesapeake &c. Canal Co. *v.* Blair, 45 Md. 102.

have been lost, might put it in the hands of third persons to prejudice the rights of the public by imposing upon them as purchasers one or the other of those certificates. Both cannot be good. The certificate is only the symbol; it is not the stock. There may be two certificates in respect of the same shares, but there cannot be two sets of the same shares held in full ownership by two different persons, or by one person. If one certificate is good so as to confer the rights of a shareholder upon its owner, the other is void, except as giving an action for damages against the corporation. This is obvious when it is considered that the shares of a corporation can only be increased in the manner pointed out by its charter or governing statute, and not by the misprisions of its ministerial officers. Upon this ground it has been held that if all the shares which the company is empowered to issue have been issued, and if other shares are thereafter issued, such excessive issue of shares is void, and does not even make their holders liable to creditors of the company.[1] If, then, a corporation can be compelled, on proof satisfactory to a court of equity and a bond of indemnity being given, to issue other original certificates in place of certificates claimed to have been lost, it may place in the hands of third parties the means of defrauding the public by conveying to them certificates of shares which do not give to them the rights of shareholders, but which give to them only the right to maintain a lawsuit against the company. Such was the view taken by the St. Louis Court of Appeals in Keller *v.* Eureka Brick Machine Co.[2] That was a case in which the corporation refused to issue, to a stockholder who had lost or mislaid his certificate, a new certificate which should, upon its face, purport to be an original, and contain no notice that it was issued in lieu of others claimed to have been lost; but offered him a certificate containing the word "duplicate" and also the words, "These certificates were

[1] Scoville *v.* Thayer, 105 U. S. 143, 148, and cases cited.

[2] 43 Mo. App. 84; *s. c.* 9 Ry. Corp. L. J. 123; Biggs, J., dissenting. *Contra*, Phillips *v.* New Orleans Gas Light Co., 25 La. Ann. 413. In this case there was a by-law providing for the issue of new certificates in place of lost ones; and the court authorized this to be done without indemnity, taking the view that the holder of the certificate supposed to be lost would have no rights against the company. This may be the law of Louisiana, but it certainly is not the general law of the country.

issued in lieu of Nos. 45, 46, 47 and 48, claimed to have been lost and unindorsed," and also the words, "duplicate — original claimed to have been lost." The action was a suit in equity to compel the defendant company to issue to the plaintiff other certificates without such words. Said THOMPSON, J., in delivering the opinion: "It is not necessary, for the purposes of this decision, for us to express an opinion as to which of the certificate holders in such a case would be entitled to the rights of stockholders as against the company. That question could only properly arise for determination in the contingency named, and we ought not to express an opinion on it in this case, especially as no parties directly interested in determining it are before the court. It is sufficient for the purposes of this case for us to say that there are opposing theories on the subject. The New York doctrine is that the one whose transfer is first regularly made on the books of the corporation is the real stockholder.[1] But, on the other hand, the Supreme Court of Illinois has held that if the secretary of a corporation issues new certificates of stock to one claiming to have purchased existing shares therein, without taking up and cancelling the original, the new certificates will be invalid.[2] Under this theory it is possible (though we do not so decide) that if relief were granted in this case, as demanded by plaintiff, a *bona fide* purchaser of the new certificates would get no rights as a shareholder, but only an action for damages against the corporation. Assuming that such a result is possible, it follows that any person to whom a certificate of corporate stock is offered for sale, which has been issued in lieu of another certificate still outstanding, has a right to know that fact. Upon what principle then shall a court of equity oblige a corporation to issue, in such a case as this, a new certificate concealing that fact? The concealment of such a fact by the holder from a purchaser might be such a fraudulent concealment as would avoid the sale. Can a court of equity make itself a party to such a fraudulent concealment?"

§ 2045. Suit by the Company to Determine Conflicting Equities of the Holders of Duplicate Certificates. — Where a

[1] New York &c. R. Co. *v.* Schuyler, 17 N. Y. 592; 34 N. Y. 30.

[2] Hall *v.* Rose Hill Road Co., 70 Ill. 673.

corporation had embarrassed itself by issuing a duplicate certificate for certain shares of stock in place of one which had been lost, and which had passed into the hands of an innocent taker, who was then demanding that the stock should be transferred upon the books to his name, — a petition in the nature of a bill in equity, setting up these facts, and praying a determination of the rights of the holders of the respective certificates, was held to present no ground of equitable cognizance, for the reason that it stated a perfect title to the stock in the holder of the new certificate; and that the possession of the old certificate by the person into whose hands it had come, and the statement of facts tending to show that he would bring an action at law to enforce his rights under it, gave the plaintiff no cause of action against him.[1]

§ 2046. Liability of the Corporation for Over-issues. — Where the charter or other governing statute, or the articles of association or other constating instrument fixes the amount of capital which the corporation may have, and the number or aggregate amount of shares which it may issue, and this amount is filled up by valid issues, any further issues are illegal, and the purchasers do not acquire the rights of shareholders. They cannot compel the corporation to register them or their nominees as shareholders on its books; they cannot vote at corporate elections; they cannot participate in corporate dividends, and they are not liable as stockholders for corporate debts. But, on principles elsewhere stated,[2] they have an action for damages against the corporation for the wrong thereby done to them.[3]

§ 2047. Motive of Valid Issue of Stock not Examinable. — If an issue of its shares by a corporation is valid under the terms of its governing statute, it is plain that the *object* which the

[1] Buffalo Grape Sugar Co. *v.* Alberger, 22 Hun (N. Y.), 349.

[2] *Ante*, §§ 1493, 1494.

[3] Allen *v.* South Boston R. Co., 150 Mass. 200; *s. c.* 15 Am. St. Rep. 185; 5 L. R. A. 716. Analogous cases are: Supply Ditch Co. *v.* Elliott, 10 Colo. 327; *s. c.* 3 Am. St. Rep. 587; Tome *v.* Parkersburg R. Co., 39 Md. 36; *s. c.* 17 Am. Rep. 540; Tomkinson *v.* Balkis Consol Co., 2 Q. B. 614. Otherwise where the taking is not a *bona fide* purchase. Farrington *v.* South Boston R. Co., 150 Mass. 406; *s. c.* 15 Am. St. Rep. 222.

directors, or some of them, have in view in selling it, will not be judicially inquired into, — as where they issue it to enable the sharetaker to vote in a certain manner at a coming election.[1]

§ **2048. No Power to Issue Its Stock at Less than Par.** — We have elsewhere fully discussed the rule that, in the absence of express statutory authorization, a corporation has no power to issue its capital stock in the first instance at a less price than that fixed by its charter, governing statute or other governing instrument; and we have noted the recent modifications of the rule made by the Supreme Court of the United States.[2] Under that rule, it was held by Mr. Justice McLean at circuit that the sale of stock in a railroad company by the directors at a less rate than the price fixed in the charter, is a fraud upon the law and the stockholders. The issuing by the directors of a bond convertible into stock is the same in effect as the sale of so much stock, and the sale of such a bond at a discount is unlawful and void. Stock thus taken is, in the hands of a party with notice, subject to the right of prior subscribers to have it reduced to the charter value of the shares.[3] The learned justice also held that a power given to the directors, by the charter, to sell the property of the company, or notes and bonds belonging to it, does not apply to the capital stock, nor does the power to terminate the time and terms of payment of subscriptions for stock have any reference to its price. The case was different in principle from the sale of stock on execution or under the charter on default of payment, in which case the gain or loss is that of the delinquent stockholder, the other stockolders not being in any way affected. It was not necessary that the charter should contain a prohibition against taking subscriptions at less than the charter price.[4] This is nothing more than the expression of a legal principle gone into at length elsewhere,[5] that, as between a corporation and a subscriber to its shares, its shares must be paid for, according to their par value, either in money or in money's worth; that the managers of the corporation and the share-taker will not be allowed, by any device, to escape the operation of this rule, it

[1] State *v.* Smith, 48 Vt. 266.

[2] *Ante*, § 1562, *et seq.*

[3] Sturges *v.* Stetson, 1 Biss. (U. S.) 246.

[4] Sturges *v.* Stetson, 1 Biss. (U. S.) 246.

[5] *Ante*, § 1562, *et seq.*

being a rule of public policy; and that, wherever shares are issued with the understanding that they are not to be paid for in full, the law will compel their full payment for the benefit of creditors. Before finally parting with this subject, we wish to note that in a case decided since the discussion in the previous part of this work which is above referred to, was printed, the House of Lords have held, that a limited company has no power to issue shares at a discount, and that those taking them are liable to pay, in a winding up, the full amount of the shares.[1]

§ **2049. Purchaser of Such Stock may Rescind.** — The issue of corporate stock at less than its par value is a fraud upon stockholders who do not consent to such an arrangement, because it admits other partners, so to speak, into the enterprise on terms more favorable than have been allowed to them. It is a fraud on future creditors of the company, because they are thereby induced to give credit to it on the belief that it has tangible assets, either consisting of money, or what money has purchased, to the extent of the shares of stock so issued. It is a fraud upon subsequent purchasers of the shares, because they buy them on the faith that they have been paid for, and that value equal to the par value which they represent, and in respect of which they are a credit, has been paid into the treasury of the corporation. Such a transaction has been therefore justly denounced as a *fraud upon the law*. A subsequent purchaser of corporate shares, which have been issued as paid up at less than their par value, is not bound to retain them after discovering the fraud which has been practiced upon him; but unless equitable obstacles intervene, he may elect to rescind the contract and recover of his vendor the purchase price, provided his vendor participated in the illegal issue of the shares.[2]

§ **2050. Right of Prior Stockholders to Reduce it to Amount Actually Paid.** — Moreover, where stock is thus fraudulently

[1] Ooregum Gold M. Co. *v.* Roper, 61 L. J. (N. S.) 337; *s. c.* 66 L. T. (N. S.) 427; Re Almada and Tirito Co., 38 Ch. Div. 415; *s. c.* 57 L. J. Ch. 706; 59 L. T. (N. S.) 159, (overruling Re Ince Hall Rolling Mill Co., 23 Ch. Div. 545; Re Plaskynaston Tube Co., 23 Ch. Div. 542.) See also Re Addlestone Linoleum Co., 37 Ch. Div. 191; *s. c.* 57 L. J. Ch. 249.

[2] Fosdick *v.* Sturges, 1 Biss. (U. S.) 255.

issued at less than its par value, it is the right of prior stockholders, who have taken their shares at their par value, to have the shares thus fraudulently issued reduced to correspond with the amount actually paid for them, provided they remain in the hands of persons who take them with notice of the fraud.[1]

§ 2051. **Power of Corporation to Pledge its Unissued Shares.** — It has been held that, in the absence of a statute expressly conferring such a power, a corporation has no power to pledge its unissued shares. Such was the conclusion of the Supreme Court of California in respect of a railway corporation, upon an examination of the statutes of that State relating to such corporations, — which statutes contemplated that shares should be issued only to subscribers who should either pay or engage to pay for the same. The court did not question the view that a corporation might issue its stock *in payment* of its indebtedness, but denied that it could issue it in pledge to secure such indebtedness. The court also conceded that where stock is issued in the usual manner, and afterwards becomes the property of the corporation, and is held in such a manner that it does not merge, the corporation may deal with it the same as any other stockholder, unless prohibited by statute. But the court reasoned that the claim of authority to pledge the unissued stock necessarily assumes the very point in controversy, the authority of the corporation to issue its stock without purchase or payment.[2] Indeed, this conclusion is almost mathematically axiomatic. A corporation is not the owner of its own shares, unless it acquires them by some process such as that above pointed out. Previous to their being issued, they cannot in any proper sense be called the property of the corporation. The conclusion that a corporation can be a shareholder is in itself absurd. "When the certificates of stock are issued to a stockholder, they are, in his hands, the muniments and evidence of his title to a given share in the property, income, and franchises of the corporation.[3] The corporation possesses only the right, the power

[1] Fosdick *v.* Sturges, 1 Biss. (U. S.) 255.

[2] Brewster *v.* Hartley, 37 Cal. 15; *s. c.* 99 Am. Dec. 237, 245. But see *ante*, § 1597. This power has been conferred in some States *by statute*. *Post*, § 2935.

[3] Citing Mechanics Bank *v.* New York &c. R. Co., 13 N. Y. 627.

to issue the stock, and a condition precedent to the exercise of the power is the purchase and payment for the stock. This restriction, if it may be properly so called, is not more unreasonable than those relating to the amount of money the corporation may borrow, and the rate of interest it may pay, and they all tend in some degree to protect the stockholders and creditors. If the power exists in the corporation to issue stock to secure a loan or indebtedness, it is practically unlimited, and the directors may issue and pledge all the capital stock not held by stockholders, as security for a trifling loan, and by the aid of the stock thus issued, they may increase the capital stock, and pledge the new stock to secure another loan, and thus perpetuate themselves in power beyond the reach of redress on the part of the stockholders, who may have contributed much the larger portion of the assets of the corporation.[1]

§ 2052. Corporation may be Estopped from Denying its Power to Pledge its Unissued Shares.— It has sometimes been held that a corporation, although expressly prohibited by statute[2] or by the terms of its charter, to issue at less than par, will nevertheless be estopped from denying the validity of a pledge of its unissued shares, after having reaped the benefit of the transaction.[3]

§ 2053. View that a Charter Power to Mortgage Capital Stock Refers to Actual and not Potential Stock.— In a charter which underwent examination before Mr. Justice McLean at circuit, it was provided that, to secure the payment of money and the interest thereon, borrowed, " the directors may pledge, by mortgage or otherwise, their entire road, fixtures and equipments, with the income and resources thereof, together with the capital stock." He held that this referred to the stock actually subscribed, and not to the potential or unsubscribed stock. "What," said he, "was meant by the capital stock in this provision? Does it refer to the stock named in the charter, and for which no subscription has been made? Such stock is a legal

[1] Brewster *v.* Hartley, 37 Cal. 15, 30; *s. c.* 99 Am. Dec. 237, 246, opinion by Rhodes, J. Compare Combination Trust Co. *v.* Weed, 2 Fed. Rep. 24.

[2] See for instance, Gen. St. N. H c. 134, § 8.

[3] Peterborough R. Co. *v.* Nashua &c R. Co., 59 N. H. 385; Gasquet *v.* Crescent City Brewing Co., 49 Fed. Rep. 496.

fiction. It is not *in esse*, and, as such, cannot be a subject of mortgage. What security under the mortgage could it afford? It is, at least, nothing more than a right to subscribe for stock, which is common to all persons; and every one who does subscribe confers a favor on the company. The power given to the directors to pledge the capital stock was, undoubtedly, intended to cover the capital stock, which was owned by the stockholders, and was property that might be mortgaged at the time."[1] This decision, though intended to be clear, is quite vague, and is obviously untenable. A corporation cannot own its own shares, but they are owned by individuals, to wit, by its shareholders. It would therefore be absurd to impute to the legislature an intent to confer upon a corporation a power to mortgage the property of other people. Such a power would be clearly unconstitutional.

§ 2054. Corporation cannot Purchase Its Own Shares. — The capital stock of a corporation being a trust fund for creditors, the general rule, in the absence of an enabling statute, is, that a corporation cannot employ its funds in purchasing its own shares, thus distributing its capital among its shareholders to the manifest detriment of its creditors.[2] As was observed by Lord Herschel, L. C.: "Stringent precautions to prevent the reduction of the capital of a limited company without due notice and judicial sanction, would be idle if the company might purchase its own shares wholesale," and if it were otherwise, the result would be that the shareholders would receive back the money sub-

[1] Sturges *v.* Stetson, 1 Biss. (U. S.) 246; 10 Myer Fed. Dec., § 144.

[2] *Ante*, § 1576; Trevor *v.* Whitworth, 12 App. Cas. 409; *s. c.* 57 L. J. Ch. 28; 57 L. T. (N. S.) 457; 36 Week. Rep. 145; German Savings Bank *v.* Wulfekuhler, 19 Kan. 60; Crandall *v.* Lincoln, 52 Conn. 73; *s. c.* 52 Am. Rep. 560, 566; Coppin *v.* Greenlees &c. Co., 38 Oh. St. 275; *s. c.* 43 Am. Rep. 425; Barton *v.* Port Jackson &c. Plank Road Co., 17 Barb. (N. Y.) 397; Heggie *v.* People's Building &c. Asso., 107 N. C. 581; *s. c.* 12 S. E. Rep. 275; Marshall Foundry Co. *v.* Killian, 99 N. C. 501; Zulueta's Claim, L. R. 5 Ch. 444, reversing *s. c.* L. R. 9 Eq. 270; Ex parte Credit Foncier & Mobilier of England, L. R. 7 Ch. 161; Morgan's Case, 1 De G. & Sm. 750; *s. c.* 1 Mac. & G. 225; 1 Ha. & Tw. 320; Re Clayton Mills Co., 37 Ch. Div. 28; Matter of Reciprocity Bank, 22 N. Y. 18; Johnson *v.* Laflin, 103 U. S. 800; affirming *s. c.* 5 Dill. (U. S.) 65; Bank Cases, 331; 6 Cent. L. J. 124; Currier *v.* Lebanon Slate Co., 56 N. H. 262. *Contra*, Verplanck *v.* Mercantile Ins. Co., 1 Edw. Ch. (N. Y.) 84; Hartridge *v.* Rockwell, R. M. Charlt. (Ga.) 260; Gillet *v.* Moody, 3 N. Y. 479. Compare Joint-Stock Discount Co. *v.* Brown, L. R. 3 Eq. 139; *s. c.* L. R. 8 Eq. 381; Jessopp's Case, 2 De G. & J. 638.

scribed, and there would thus pass into their pockets what before existed in the form of cash in the coffers of the company, or of buildings, machinery, or stock available to meet the demands of the creditors. And he also held that the purchase of shares for the purpose of reselling would be a trafficking or dealing in shares and unlawful.[1] The rule which forbids a corporation thus to employ its funds rises to the grade of a rule of public policy; and is so strong that, although power is conferred upon the company to deal in the shares of joint-stock companies generally, this does not authorize it to deal in its own shares.[2] It is immaterial whether the transfer is made to the company itself, or to a nominee of the directors to hold in trust for the company; in the latter case, equally with the former, it is invalid.[3]

§ 2055. Notwithstanding Such Purchases, Stockholder Remains Liable to Creditors.— Where, then, a corporation is prohibited from purchasing its own shares, such transfers, made to a body incapable of taking, stand as if no transfer had been made; and although equities may arise out of them as between the immediate parties to the transaction,[4] yet they leave the transferor liable as a contributory in the event of a winding-up,[5] and responsible to creditors as a shareholder.[6] Nor does the fact that the governing statute provides that the stockholder may exonerate himself from liability on account of existing debts by a *bona fide* transfer of the stock on the bonds to a resident of the State, of full age, enable the stockholder to exonerate himself by transferring the stock to the corporation itself. The purchaser of the stock must be one who succeeds to a lia-

[1] Trevor *v.* Whitworth, 12 App. Cas. 409, 416; *s. c.* 57 L. J. Ch. 28; 57 L. T. (N. S.) 457; 36 Week. Rep. 145.

[2] Zulueta's Claim, L. R. 5 Ch. 444; reversing *s. c.* L. R. 9 Eq. 270.

[3] Daniell's Case, 22 Beav. 43; Munt's Case, 22 Beav. 55; Morgan's Case, 1 Mac. & G. 225; *s. c.* 1 Ha. & Tw. 320; 1 De G. & Sm. 750; Eyre's Case, 31 Beav. 177; Richmond's Executor's Case, 3 De G. & Sm. 96; Ex parte Henderson, 19 Beav. 170; Walter's 2d Case, 3 De G. & Sm. 244.

[4] Ex parte Morgan, 1 Mac. & G. 225.

[5] Ex parte Henderson, 19 Beav. 107; Eyre's Case, 31 Beav. 177; Ex parte Morgan, 1 Mac. & G. 225; Daniell's Case, 22 Beav. 43; Munt's Case, 22 Beav. 55; Richmond's Executor's Case, 3 De G. & Sm. 96; Walter's 2d Case, 3 De G & Sm. 244.

[6] Matter of Reciprocity Bank, 22 N. Y. 18.

bility, distinct from and in addition to that of the corporation.[1]

§ **2056. Rescission of Such Contracts.**— As in the case of any other unlawful contract, either party to such an engagement may withdraw from it before it has become so far executed that the other party cannot be put *in statu quo*. Thus, it has been held that a deposit of corporate stock, made by a stockholder with the directors or their agent, to enable the stock to be voted on and to be sold, is *revocable* before sale, for the reason that the directors thereby acquired no vested right therein sufficient to prevent a sale.[2] Moreover, a court of *equity* has the power to order a *retransfer* of stock, or the issuing of new shares, where justice between the parties requires it, the amount of capital authorized by the charter not being exceeded by such issue.[3]

§ **2057. Liability of Directors in Such Cases.**— If the directors of a corporation commit an *ultra vires* act, they are, technically at least, guilty of a breach of trust; and this is obviously so, whether the act is beyond the power conferred by the shareholders upon the directors, or beyond the power conferred upon the corporation by the sovereign. But as directors in general receive no salary for acting as such, they are liable only as mandataries, and hence would not be personally liable to the company for losses happening in consequence of an *ultra vires* act, unless it was the result of fraud or of gross negligence, and want of attention to their duties.[4] But there is something essentially corrupt in the transactions which we have just been describing. They have the effect of distributing the capital stock of the company to particular members, to the prejudice of the rest and in fraud of the rights of creditors. If the directors of the company expend the funds of the company

[1] *Ibid.* See also Alvord *v.* Miller, 32 Conn. 543.

[2] Woodruff *v.* Dubuque &c. R. Co., 30 Fed. Rep. 91.

[3] Williams *v.* Savage Man. Co., 3 Md. Ch. 418.

[4] Joint Stock Discount Co. *v.* Brown, L. R. 3 Eq. 139; *s. c.* L. R. 8 Eq. 381. See Charitable Corp. *v.* Sutton, 2 Atk. 400; Spering's Appeal, 71 Pa. St. 11; Hodges *v.* New England Screw Co., 1 R. I. 312; *s. c.* 53 Am. Dec. 624; 3 R. I. 9; Thomp. Off. Corp. 356.

in this way, they are guilty of a breach of trust, and a court of equity will compel them to make good the moneys so expended;[1] and, in the event of the insolvency of the company, they will be so chargeable at the suit of creditors.[2] The same may be said of secret arrangements among the directors, by which the amounts due by one or more of them, on account of his subscription to the capital stock of the company, is cancelled and discharged. While such arrangements do not have the effect of releasing the particular directors,[3] yet if the company actually sustains loss in consequence of them, the directors will be held bound to make good the loss.[4] The same rule has been applied where directors of an abortive company attempted to indemnify the shareholders by paying them back their deposits.[5] But it has been held that if the directors of a corporation enter into a contract on behalf of the corporation whereby the corporation assumes to purchase certain of its own shares, and if the corporation thereafter sustains an action by which the purchase is set aside on the ground that the corporation has no power to make such a contract, — an action on the contract can not be maintained against the directors on the theory of a *breach of warranty of agency*, or the theory that since the corporation is not bound the directors must be.[6]

§ **2058. Applications of the Rule.**— Under the operation of the rule, it has likewise been held that a contract by some of the directors and a majority of the stockholders of a corporation, without the knowledge or consent of the other stockholders, that if a third person will purchase certain stock and manage the corporation for a stated time,

[1] Hodgkinson *v.* National Live Stock Insurance Co., 26 Beav. 473.

[2] Evans *v.* Coventry, 25 L. J. (Ch.) 489; *s. c.* on appeal, 8 DeG. M. & G. 835.

[3] Thompson on Stockholders, § 124.

[4] Hodgkinson *v.* National Live Stock Insurance Co., 26 Beav. 473; Bank of St. Marys *v.* St. John, 25 Ala. 566, 612.

[5] Williams *v.* Page, 24 Beav. 654. See also Clement *v.* Bowes, 1 Drew, 684.

[6] Abeles *v.* Cochran, 22 Kan. 405; *s. c.* 31 Am. Rep. 193. As to the doctrine which holds the agent liable, on the theory of breach of warranty of agency or tortious concealment, where he fails to disclose a responsible principal, see Ogden *v.* Raymond, 22 Conn. 379, 384: *s. c.* 58 Am. Dec. 429; Aspinwall *v.* Torrance, 1 Lans. (N. Y.) 381; Smout *v.* Ilbery, 10 Mees. & W. 1; McCurdy *v.* Rogers, 21 Wis. 197; *s. c.* 91 Am. Dec. 468; Rashdall *v.* Ford, L. R. 2 Eq. 750; Beattie *v.* Ebury, L. R. 7 Ch. 777

they will pay him a salary and repurchase his stock for a certain per cent. of the par value, if he desires to sell at the end of the time, is void as against public policy, as against those not consenting to it, and not validated by the good faith of the parties.[1] The reason was that the agreement tended to the prejudice of the other shareholders. - - - - A limited company was incorporated under the English joint-stock company's acts, with the objects, as stated in its memorandum, of acquiring and carrying on a manufacturing business, and any other businesses and transactions which the company might consider to be in any way conducive or auxiliary thereto or in any way connected therewith. The articles authorized the company to purchase its own shares. The company having gone into liquidation, a former shareholder made a claim against the company for the balance of the price of his shares sold by him to the company before the liquidation and not wholly paid for. It was held that such a company, having no power under the acts to purchase its own shares, the purchase was *ultra vires*, and the claim must fail.[2]

§ 2059. Shareholders Liable to Receiver of Corporation. — Where the purchase of its own stock was by a trust company, empowered by its charter to execute all trusts, fiduciary or otherwise, committed to it by private parties or by any court or tribunal or legally constituted authority in the State, and to act as guardian or receiver, the charter providing that " all the capital stock, property and estate of every kind belonging to said company shall be and shall stand charged with the fulfillment of said trusts, and the payment of said deposits, and said trust and other funds, as first and prior liens thereon in case of the failure of said corporation," — it was held that receivers, into whose hands the corporation had passed in consequence of its insolvency, could maintain actions against the stockholders to recover back the money which they had so received from the corporation.[3]

§ 2060. A Corporation may be Vested with Such Power by its Charter. — If a corporation is specially authorized by its charter, it may, of course, deal in its own stock, as in any other article of merchandise. The Supreme Court of the State of Washington has held that, for the purpose of restraining the contract of a foreign corporation, made on issuing its stock, to

[1] Wilbur *v.* Stoepel, 82 Mich. 344; *s. c.* 46 N. W. Rep. 724.

[2] Trevor *v.* Whitworth, 12 App. Cas. 409; *s. c.* 57 L. J. (Ch.) 28; 57 L. T. (N. S.) 457; 36 Week. Rep. 145.

[3] Crandall *v.* Lincoln, 52 Conn. 73; *s. c.* 52 Am. Rep. 560.

repurchase it on certain conditions, the court would *presume* that it was vested with power, under its charter, to deal in its own stock, and further that the stock was not an original issue, but a resale of stock lawfully in its hands for such purpose.[1]

§ 2061. Charter Under Which Company May Purchase its Own Shares.—Under a charter which empowers the corporation to "acquire and transfer, purchase and hold, sell or exchange any real estate or *other property* that may be deemed desirable in the transaction of its business," it has been held that the corporation has the power to purchase its own shares.[2] When, therefore, a corporation brought an action against an individual for an accounting and for the surrender of certain notes and the defendant alleged, by way of counterclaim, that he bought the stock of the plaintiff corporation, to a certain amount, upon an agreement that the plaintiff would purchase it of him on certain conditions, which had been subsequently fulfilled,—it was held that this was a good defense.[3]

§ 2062. View that Corporation may Buy and Sell its Own Shares.—Some of the American courts have taken the view that corporations, when not prohibited by their own charters or by statute, may buy and sell their own shares, provided they do so in good faith without intending to injure their creditors, and provided their creditors are not in fact injured thereby.[4] Even

[1] Yeaton *v.* Eagle Oil &c. Co., 4 Wash. 183; *s. c.* 29 Pac. Rep. 1051.

[2] Iowa Lumber Co. *v.* Foster, 49 Ia. 25; *s. c.* 31 Am. Rep. 140. It is respectfully submitted that this conclusion is unsound. But see a similar ruling by the same court in a later case where the power granted by the charter was "to make contracts; to acquire by deed, lease, assignment, or otherwise, any property both real and personal; * * * and do all other acts and exercise all other powers necessary to the conduct of its business as fully as private individuals might do." Rollins *v.* Shaver Wagon &c. Co., 80 Iowa, 380; *s. c.* 45 N. W. Rep. 1037.

[3] Iowa Lumber Co. *v.* Foster, *supra.*

[4] First Nat. Bank *v.* Salem Capital Flour-Mills Co., 39 Fed. Rep. 89; *s. c.* 6 Rail & Corp. L. J. 209; Dupee *v.* Boston Water Power Co., 114 Mass. 37; Leland *v.* Hayden, 102 Mass. 542; American Railway-Frog Co. *v.* Haven, 101 Mass. 398; Nesmith *v.* Washington Bank, 6 Pick. (Mass.) 324, 329; Chicago &c. R. Co. *v.* Marseilles' 84 Ill. 145 and 643; Chetlain *v.* Republic L. Ins. Co. 86 Ill. 220; Clapp. *v.* Peterson, 104 Ill. 26; Republic Life Ins. Co. *v.* Swigert, 135 Ill. 150; *s. c.* 9 Rail & Corp. L. J. 22; 25 N. E. Rep. 680; Frazer *v.* Ritchie, 8 Ill. App. 554; City Bank of Columbus *v.* Bruce, 17 N. Y. 507; Hartridge *v.* Rockwell, R. M. Charlt. (Ga.) 260; Eggmann *v.* Blanke, 40 Mo. App. 318 (under Ill. Stat.).

if such a transaction is invalid, an attack upon it by a stockholder must be made in a direct proceeding. Where he sues to recover his share of the benefit resulting from such a purchase, his action is an affirmance, and he cannot be heard to impeach the validity of the corporate action.[1] In a recent case the Supreme Court of North Carolina have re-affirmed this doctrine and carried it to its logical conclusion, by holding that since the company is bound by its contracts, its agreements with the persons from whom it purchases such shares of stock, may be enforced by proper legal remedies just as agreements in respect to any other species of property; that, having made its promissory note to one of its stockholders for the price of his shares, he would have his remedy, so far as it was concerned, just as any other creditor would, subject only to the possible rights of other creditors against him in cases wherein he might be liable; and that if he were not liable to other creditors, in some way as a stockholder, he would be on the same footing as such creditors.[2] Some of the cases which recognize the power of a company to purchase its own shares, strictly limit the right to exercise it to circumstances under which the rights of creditors are not involved.[3] But if the transaction injuriously affect the rights of a creditor, it will be held void although made in good faith by the exchange of property of equal value and without any element of fraud in it; and even though, at the time of the transfer, the fact of indebtedness was not established and was unknown to the stockholder.[4]

§ 2063. Creditors Alone can Impeach a Sale of Stock to the Company. — Under the theory of these cases, the preservation of the rights of creditors being the only reason for a limitation upon the power of corporations to purchase their own stock, it has been held that creditors alone may impeach such a transaction. And since, where a receiver is appointed to take charge

[1] Coleman *v.* Columbus Oil Co., 51 Pa. St. 74.

[2] Blalock *v.* Kernersville Mfg. Co., 110 N. C. 99; *s. c.* 14 S. E. Rep. 501. Compare Marshall Foundry Co. *v.* Killian, 99 N. C. 501; *s. c.* 6 Am. St. Rep. 539; Heggie *v.* Building &c. Assn., 107 N. C. 581; *s. c.* 12 S. E. Rep. 275.

[3] Re Columbian Bank, 147 Pa. St. 422; *s. c.* 29 W. N. C. 453, 458; 23 Atl. Rep. 626, 628.

[4] Clapp *v.* Peterson, 104 Ill. 26

of the property and assets of a corporation, he is, for the purpose of determining the nature and extent of his title, regarded as representing only the corporate body itself, and not its creditors and shareholders, and is vested by law with the estate of the corporation, and for purposes of litigation takes only the rights of the corporation such as could be asserted in its own name, — a resolution of the company, duly passed, cancelling all certificates of stock not fully paid, and issuing new paid-up certificates for the amount of the surrendered stock actually paid, was held to be, in effect, a purchase by the company of the unpaid stock at its par value and binding between the corporation and the stockholders, so that it could not be avoided by a receiver of the company.[1]

§ 2064. View that the Corporation may be the Beneficial Owner of its Own Shares.— We have already had occasion to inquire[2] whether a corporation can be the beneficial owner of its own shares. As the shares of a corporation are in the nature of corporate debts, the inquiry is analogous to the inquiry whether a man can become the owner of his own debts, by buying up the paper evidence of them and holding them in the name of a trustee.[3] Where the unissued stock of a corporation was, by agreement of all the stockholders (there being no creditors), paid with corporate funds, and issued to one stockholder to be held in trust for all, — it was held that the issue was valid, and that the directors had no authority afterwards to direct the stock to be sold.[4]

§ 2065. Power of National Banks in this Respect. — The question has been frequently presented in respect of such purchases of their own shares made by national banks; and the conclusion seems to be that while such banks have no power to become the general and unlimited owners of their own shares,[5] yet, like other corporations,[6] they may purchase their own or other shares to protect themselves from loss on a debt; though in such a case

[1] Republic L. Ins. Co. *v.* Swigert, 135 Ill. 150. Compare Crandall *v.* Lincoln, 52 Com. 73; *s. c.* 54 Am. Rep. 560. The prevailing view is that a receiver of a corporation *represents creditors*, and in their behalf can impeach illegal acts of the corporation. *Post*, § 3561, *et seq.*

[2] *Ante*, § 1107.

[3] See *post*, § 2069.

[4] Jones *v.* Morrison, 31 Minn. 140.

[5] Meyers *v.* Valley Nat. Bank, 18 Bankr. Reg. 34.

[6] *Post*, § 2068; National Bank of Charlotte *v.* National Exchange Bank of Baltimore, 39 Md. 600.

the bank is bound, under the operation of the statute,[1] to sell the shares within six months; and it may sell them on credit and take the purchaser's note, with the stock sold as collateral to secure it, provided this is done in good faith.[2]

§ 2066. Ultra Vires no Defense to Note Given for Such Stock. — In the case last supposed in the preceding section, if it were true that the corporation exceeded or abused its powers in the transaction, this would not be a good defense to an action on the note. The question of misuser will not be decided collaterally in such a case, by setting aside a sale otherwise good. "An abuse of its corporate powers might be a reason for punishing the bank, but would be no sufficient reason for not enforcing this contract in the interest of the creditors of the bank. The law will not permit a defendant to refuse payment upon his contract upon the ground that there was an abuse of the corporate powers in making it." [3]

§ 2067. Cannot Purchase of One Stockholder to the Exclusion of the Others.— Where the case is such that it involves only the rights of the stockholders, and not the rights of the creditors, — as where the governing statute forbids an *insolvent company* to buy its own capital stock,[4] and by implication allows a solvent corporation to do so, — the right cannot be exercised by the corporation to the exclusion of others similarly situated. In such a case a corporation cannot *reduce its capital* stock by purchasing the shares belonging to one stockholder; but each stockholder should be allowed to surrender the same proportion of his stock, as the amount of the proposed reduction bears to the aggregate of the capital stock.[5]

§ 2068. Exceptions to the Foregoing Rule. — Certain recognized exceptions to the foregoing rule exist, founded upon necessity. Thus, it is agreed that a corporation may receive its own shares from its debtor in order to save itself from loss;

[1] Rev. St. U. S., § 5141.

[2] Union Nat. Bank *v.* Hunt, 76 Mo. 440; affirming on this point 7 Mo. App. 42.

[3] Union Nat. Bank *v.* Hunt, 7 Mo. App. 42, 51, opinion by Bakewell, J.; affirmed on this point, 76 Mo. 440.

[4] N. H. Gen. Stats. ch. 135, § 3.

[5] Currier *v.* Lebanon Slate Co., 56 N. H. 262.

though it seems it has no power to do this out of mere complaisancy to shareholders who may be indebted to it.[1] There is no doubt that a corporation may receive its own shares as security for a previously existing debt contracted by the stockholder;[2] and where this was done by an incorporated bank, it was held that a court of equity would not, after a long lapse of time, compel the stockholders to resume their stock and the responsibilities attached.[3] And we have already seen,[4] that the forfeiture of shares and their consequent resumption by the corporation, is one of the recognized means of enforcing the payment of assessments. In a case where the general rule that a corporation cannot purchase its own shares was applied and enforced against the selling stockholders, it was said: "Should it loan money to a stockholder and be obliged to take its own stock in payment, that would not be illegal *per se*. So too it may be allowable for a company to purchase stock temporarily with its surplus earnings; but stock should not be held indefinitely; it should be disposed of in a reasonable time. If not, and should creditors thereby be prejudiced, perhaps the managers might be liable. Nor do we intend to say that a direct purchase would be declared illegal at the instance of a party to the transaction. If the stock is re-issued and creditors are not prejudiced, probably the courts would not interfere. But as a rule to which there are few if any exceptions, when a stockholder conveys his stock to the company and receives in return a portion of the capital, he holds the money so received subject to the superior equities of creditors."[5]

§ 2069. Power to Re-issue Such Purchased Shares — Merger — Revival.— Where a corporation has power in a given case to become the owner of its own shares, by purchase, forfeiture, or other mode, it may be stated with confidence that the

Taylor *v.* Miami Exporting Co., 6 Oh. St. 176; *s. c.* 22 Am. Rep. 785; recognized in State *v.* Oberlin Building Asso., 35 Oh. St. 258, and in Coppin *v.* Greenlees &c. Co., 38 Oh. St. 275; *s. c.* 43 Am. Rep. 425.

[2] Union Nat. Bank *v.* Hunt, 76 Mo. 440; affirming on this point 7 Mo. App. 42; German Savings Bank *v.* Wulfekuhler, 19 Kan. 60.

[3] Taylor *v.* Miami Exporting Co., 6 Ohio, 176.

[4] *Ante*, § 1762, *et seq.*

[5] Crandall *v.* Lincoln, 52 Conn. 73, 101; *s. c.* 52 Am. Rep. 560, 566. See Thompson *v.* Moxey, 47 N. J. Eq. 538; *s. c.* 20 Atl. Rep. 854.

shares do not necessarily merge or become extinguished, or that if they have merged they may be revived, so that the corporation may afterwards sell them or otherwise re-issue them.[1] It was said in an early case that it had always been the understanding and practice, that where a bank took its own shares in pledge to secure a debt, it was authorized to re-issue them whenever it saw fit.[2] In another case it was held that a corporation which has power to take its own stock in payment of debts may sell it again and take notes for the price, under the general power of the directors to manage its business.[3] Such re-issue or resale is regarded as a re-issue of old, and not an issue of new shares,[4] from which the conclusion of another court would seem to follow that, upon such a resale, the stockholders have no right of becoming purchasers in preference to the general public; nor can the directors be prevented from purchasing on the ground that they are trustees and cannot be both buyers and sellers.[5] The first proposition is clear enough; the latter is doubtful. Another court has reasoned that here, as in other cases, the question of merger depends largely upon *intention;* that such a purchase merely suspends the right to vote on the stock, and may or may not have the effect of a merger, at the option of the company; and that some manifestation of such intent should be proved, to produce that result.[6]

§ 2070. One Corporation Cannot Subscribe for Shares in Another.—Corporations aggregate can only be formed by individuals, and unless the power is conferred by statute in express terms or by necessary implication, one corporation has no faculty of becoming a corporator in another; and hence a subscription by one corporation to the capital stock of another is *ultra vires* and void.[7] But it does not follow that stockholders may not, by

[1] Commonwealth *v.* Boston &c. R. Co., 142 Mass. 146; Williams *v.* Savage Man. Co., 3 Md. Ch. 418; City Bank of Columbus *v.* Bruce, 17 N. Y. 507 Rogers *v.* Phelps, 31 N. Y. St. Rep. 872; *s. c.* 9 N. Y. Supp. 886 (land scrip).

[2] Williams *v.* Savage Man. Co., *supra.*

[3] State Bank *v.* Fox, 3 Blatchf. (U. S.) 431.

[4] City Bank of Columbus *v.* Bruce, 17 N. Y. 507.

[5] Hartridge *v.* Rockwell, R. M. Charlt. (Ga.) 260.

[6] State *v.* Smith, 48 Vt. 266.

[7] *Ante,* § 1102, *et seq;* Railway Co. *v.* Iron Co., 46 Oh. St. 44; *s. c. sub nom.*

acquiescence, lose their right to the aid of a court of justice for the purpose of setting aside such a transaction; and it has been held that this result follows where the stockholders postpone their complaint for a length of time extending from seven to fifteen years.[1]

§ 2071. But may Sometimes Acquire Shares in Another Company. — And yet there seems to be no reason in the nature of a corporation why it may not become the owner of shares in another company, considered in the light of property. And such authority is sometimes granted, either by a special provision of the corporate charter,[2] or by a statutory provision applicable to corporations generally.[3] In Georgia, on the other hand, the impolicy of permitting a corporation to acquire and hold the corporate stock of a similar organization is recognized by a constitutional enactment declaring that the legislature "shall have no power to authorize any corporation to buy shares or stock in any other corporation in this State or elsewhere."[4] And although such a power is possessed under its charter, by a foreign corporation, it can not be exercised within a State, the legislative policy of which prohibits the exercise of such power by domestic corporations.[5]

Valley R. Co. *v.* Lake Erie Iron Co., 1 L. R. A. 412; 18 N. E. Rep. 486; New Jersey Central R. Co. *v.* Pennsylvania R. Co., 31 N. J. Eq. 475; Franklin Co. *v.* Lewiston Savings Bank, 68 Me. 43; *s. c.* 28 Am. Rep. 9; Central R. Co. *v.* Collins, 40 Ga. 582. Where one corporation sells property to another for a fixed price, to be paid in stock of the latter, to be delivered to the former through its designated officer, *delivery of the certificates* of stock to such officer, or to another by his order, operates as a discharge for the price. Leathers *v.* Janney, 41 La. An. 1120; *s. c.* 6 L. R. A. 661; 6 South. Rep. 884.

[1] Alexander *v.* Searcy, 81 Ga. 536; *s. c.* 12 Am. St. Rep. 337; 8 S. E. Rep. 630.

[2] Clarke *v.* Central R. &c. Co., 50 Fed. Rep. 338; *ante*, § 1108.

[3] Act N. J. April 4, 1888; L. N. J. 1888, c. 269, p. 385, providing that corporations of the State and of any other State doing business in the State, authorized by law to own and hold shares of stock and bonds of corporations of other States, may own, hold and dispose thereof in the same manner, and with all the rights, powers and privileges of individual owners of shares of the capital stock and bonds or other evidence of indebtedness of corporations of the State.

[4] Const. Ga., art. 4, § 2, par. 4. See also Clarke *v.* Central R. &c. Co., 50 Fed. Rep. 338; Hamilton *v.* Savannah &c. R. Co., 49 Fed. Rep. 412; Langdon *v.* Branch, 37 Fed. Rep. 449.

[5] Clarke *v.* Central R. &c. Co., 50 Fed. Rep. 338.

§ 2072. Contract of the Corporation to Pay in Its Own Stock — What Amounts to a Default. — The rule that one contracting to pay in a particular commodity must have the article at the time and place designated for its delivery, or he becomes liable to pay in money, has been held not to apply to a contract by a corporation to pay in its own stock. The corporation is not in default until a demand and refusal to issue the certificate.[1]

[1] Phillips *v.* Allegheny Car Co., 82 Pa. St. 368.

CHAPTER XXXIV.

INCREASING AND DECREASING CAPITAL STOCK.

ARTICLE I. INCREASING CAPITAL STOCK.

§ 2076. Directors no Power to Increase Capital Stock. — A change so organic and fundamental as that of increasing the capital stock of a corporation beyond the limit fixed by the charter cannot be made by the directors alone, unless expressly authorized thereto. A charter authorizing an increase of the stock "at the pleasure of the corporation" does not therefore confer upon the directors power to increase the stock, for they are not, for this purpose, the corporation. The reason was thus stated at length in an opinion of the Supreme Court of the United States given by Mr. Justice Bradley: "The general power to perform all corporate acts refers to the ordinary business transactions of the corporation, and does not extend to a reconstruction of the body itself or to an enlargement of its capital stock. A corporation, like a partnership, is an association of natural persons who contribute a joint capital for a common purpose; and although the shares may be assigned to new individuals in perpetual succession, yet the number of shares and amount of capital cannot be increased except in the manner expressly authorized by the charter or articles of association. Authority to increase the capital stock of a corporation may undoubtedly be conferred by a law passed subsequent to the charter; but such a law should regularly be accepted by the stockholders. Such assent might be inferred by subsequent acquiescence; but in some form or other it must be given to render the increase valid and binding on them. Changes in the purpose and object of an association, or in the extent of its constituency or membership, involving the amount of its capital stock, are necessarily fundamental in their character, and cannot, on general principles, be made without

the express or implied consent of the members. The reason is obvious. First, as it respects the purpose and object. This may be said to be the final cause of the association, for the sake of which it was brought into existence. To change this without the consent of the associates would be to commit them to an enterprise which they never embraced and would be manifestly unjust. Secondly, as it respects the constituency or capital and membership. This is the next most important and fundamental point in the constitution of a body corporate. To change it without the consent of the stockholders would be to make them members of an association in which they never consented to become such. It would change the relative influence, control and profit of each member. If the directors alone could do it, they could always perpetuate their own power. Their agency does not extend to such an act, unless so expressed in the charter or subsequent enabling act; and such subsequent act, as before said, would not bind the stockholders without their acceptance of it, or assent to it in some form. Even when the additional stock is distributed to each stockholder *pro rata*, it would often work injustice, because many of the stockholders might be unable to take their respective shares, and might thus lose their relative interest and influence in the corporate concerns. These conclusions flow naturally from the character of such associations. Of course the associates themselves may adopt or assent to a different rule. If the charter provides that the capital stock may be increased, or that a new business may be adopted by the corporation, this is undoubtedly an authority for the corporation (that is, the stockholders) to make such a change by a stockholders' vote, in the regular way. Perhaps a subsequent ratification, or assent to a change already made, would be equally effective. It is unnecessary to decide that point at this time. But if it is desired to confer such a power on the directors so as to make their acts binding and final, it should be expressly conferred."[1]

§ 2077. But may Receive Subscriptions to Capital Stock not Filled up. — The decision just quoted contains this dictum by Mr. Justice Bradley, which no doubt expresses the correct rule:

[1] Railway Co. *v.* Allerton, 18 Wall. (U. S.) 233; 10 Myer Fed. Dec., § 134.

"Where the stock expressly allowed by a charter has not been all subscribed, the power of the directors to receive subscriptions for the balance may stand on a different footing. Such an act might, perhaps, be considered as merely getting in the capital already provided for the operations and necessities of the company, and, therefore, as belonging to the orderly and proper administration of the company's affairs. Even in such case, however, prudent and fair directors would prefer to have the sanction of the stockholders to their acts." [1]

§ 2078. **Bill in Equity by Stockholder to Prevent Such Increase.** — A dissenting stockholder may maintain a suit in equity against the directors to restrain them from making such an unauthorized increase of the capital stock.[2]

§ 2079. **No Implied Authority to Increase or Diminish.**— Corporations have no implied authority either to increase or reduce their capital stock, and can only do so when authorized by the legislature, and in the manner so authorized.[3] For instance, under the constitution and laws of Louisiana, which provide for increasing, but not for reducing such capital stock, corporations have no power to decrease their capital.[4] Where the capital stock of the corporation is limited to a certain amount, to be divided into shares of a certain amount each, and where all the capital stock so limited and divided into shares has been subscribed for and paid in, the power of the corporation to issue any additional shares of stock is exhausted.[5] Sir Nathaniel Lindley says: "If the capital of a company is fixed by its charter, letters-patent, or special act, and no power is given to increase it, such capital cannot be increased, even by the consent of all the members of the company. The distinction, however, between borrowing money and increasing capital, which was

[1] Railway Co. *v.* Allerton, 18 Wall. (U. S.) 233, 236; *s. c.* 10 Myer Fed. Dec., § 134.

[2] Railway Co. *v.* Allerton, 18 Wall. (U. S.) 233; *s. c.* 10 Myer Fed. Dec., § 134.

[3] Sutherland *v.* Olcott, 95 N. Y. 93; reversing *s. c.* 29 Hun (N. Y.); 161; Grangers Life & Health Ins. Co. *v.* Kamper, 73 Ala. 325; Winters *v.* Armstrong, 37 Fed. Rep. 508.

[4] Seignouret *v.* Home Ins. Co., 24 Fed. Rep. 332.

[5] Mech. Bank *v.* N. Y. &c. R. Co., 13 N. Y. 599, 617.

adverted to on a former occasion, must not be overlooked; for it does not follow that because a majority of the shareholders of a company can not increase the capital of the company, they can not lawfully, and against the will of the minority, borrow money on the credit of the company." [1]

§ 2080. Increase Beyond Charter Limitation, Void.— Of course, an attempt to increase the stock of the company beyond the limit fixed by its charter must be *ultra vires* and the increased stock itself therefore, void. It confers on the holders no rights and subjects them to no liabilities. If the stock of the first and second issues should be held by one set of holders, and the stock of a third and fourth, in excess of the charter limitation, by another, in a contest between them the latter would be excluded from all participation in the management of the company or in its profits. To decide that the holders of stock issued *ultra vires* have the same rights as the holders of authorized stock is to ignore and override the limitations and prohibitions of the charter. It follows that if the holder of such spurious stock has none of the rights, he can be subjected to none of the liabilities of a holder of genuine stock. His contract to pay for spurious shares is without consideration and cannot be enforced.[2]

§ 2081. Subscriber may Recover Installments where Subscription Illegal.—If the increase is illegal and the subscriber has paid money in respect of his shares, he may recover it back, as money paid on a consideration which has failed; and it seems that the rule *in pari delicto potior est conditio possidentis* does not extend to such a case. This may be illustrated by a case where A. subscribed for shares in the capital stock of a corporation, in *increase* of its stock. The proceeding was illegal, because in contravention of the statute under which the corporation was organized. A. paid a certain sum as an installment on his subscription, on the first call. By the subscription he was to forfeit all he had paid if he failed to pay subsequent calls. He so failed, and, after the corporation had declared his rights

[1] Lind. Comp. Law, 5th ed., p. 397-8; citing to the last point, Bryan *v.* Metropolitan &c. Co., 3 De Gex & J. 123; Australian &c. Co. *v.* Mounsey, 4 Kay & J. 733.

[2] Scovill *v.* Thayer, 105 U. S. 148.

to be forfeited, but before any scrip had been issued for the new stock, the corporation abandoned the plan of increasing the stock. A. sued the corporation to recover back the sum paid by him as such installment. It was held that he was entitled to recover it.[1]

§ 2082. Irregularities in Proceedings to Increase — Departures from the Statute.— The provisions of the charter or other governing statute touching such an increase must govern subsisting contractual arrangements.[2]

§ 2083. Irregularities Validated by Acquiescence and Cured by Estoppel.— But where the power to make an increase exists, mere irregularities in the mode of making the increase may be validated by acquiescence, or cured on the principle of estoppel, so as to cut off any dissenting stockholder from asserting its invalidity.[3]

§ 2084. Illustrations.— Thus, *unanimous consent* will make an increase of the capital stock of a corporation binding upon all the stockholders, though not made with the statutory formalities.[4] And where there was, under the governing statute, authority to increase the capital stock at the discretion of the stockholders, it was held that no formal vote was necessary to make the increase, but that the requisite assent of the stockholders could be shown by their conduct and acquiescence.[5] And this assent may be shown by accepting shares of the increased capital so issued, so as to cut off the right of objecting to the failure of the corporation to record and publish the fact of the increase.[6] And hence, where all the stockholders of a corporation assent to the action of a stockholders' meeting in increasing the capital stock, or ratify such action, they can not afterwards raise the objection to such increase that no formal notice of the meeting was given, or that it

[1] Knowlton *v.* Congress Spring Co., 14 Blatchf. (U. S.) 364.

[2] Ohio Ins. Co. *v.* Nunnemacher, 15 Ind. 294.

[3] Railway Co. *v.* Allerton, 18 Wall. (U. S.) 233; Payson *v.* Stoever, 2 Dill. (U. S.) 428; Bailey *v.* Champlain &c. Co., 77 Wis. 453; *s. c.* 46 N. W. Rep. 539; Stutz *v.* Handley, 41 Fed. Rep. 531; reversed on other grounds, *s. c. sub nom.* Handley *v.* Stutz, 139 U. S. 417; Byers *v.* Rollins, 13 Colo. 22; *s. c.* 21 Pac. Rep. 894.

[4] Pool *v.* West Point &c. Assoc., 30 Fed. Rep. 513; Bailey *v.* Champlain &c. Co., 77 Wis. 453; *s. c.* 46 N. W. Rep. 539.

[5] Payson *v.* Stoever, 2 Dill. (U. S.) 428.

[6] Stutz *v.* Handley (Tenn.), 41 Fed. Rep. 531.

was held in another State than that in which the corporation was chartered, there being nothing in the charter to prohibit its being so held.[1] Nor will the failure to enter on the minutes of the company a vote of the stockholders by which its capital stock is increased at all affect the validity of the act of increase; since most corporate acts can be proved by parol.[2]

§ 2085. Further Illustrations: When not a Defense to an Action for Calls.— On like grounds, an irregularity committed by the officers of the corporation in a proceeding to increase the capital stock of the company, as where the law requires the certificate of increase which is to be filed with the Secretary of State to show the whole amount of the capital stock paid in, and also the debts and liabilities of the company, and the certificate which was filed did not show these facts, it was held that one who had subscribed for shares of the stock so increased, could not set up this irregularity as a defense, when sued by the corporation to enforce his contract of subscription. The court referred for the reason of its decision, to the general principle that "parties recognizing the existence of corporations have no right to object to irregularities in their organization. If the State chooses to tolerate such irregularities, it is not for individuals to question its acts, certainly not for individuals who make contracts with them. The defendant's subscription was a contract with the company, and recognized the existence of increased stock. In point of fact, the stock had been increased, but the certificate of the increase did not in all respects comply with the law. The certificate was imperfect, but, as it was on the public records, it was open to the inspection of all who desired to subscribe. If there were defects in it which would have influenced the defendant in his subscription, he had the opportunity of informing himself as to the facts. He chose to subscribe to the stock, the increased stock *de facto*."[3] But a subscription under such circumstances, without any payment thereon, or any subsequent act of recognition, would not, it was held, but on what grounds are not apparent, bind the defendant.[4]

§ 2086. Shareholders not Allowed to Set up Irregularities after Insolvency. — An unauthorized increase of the capital stock

[1] Stutz *v.* Handley, 41 Fed. Rep. 531; reversed on other grounds *sub nom.* Handley *v.* Stutz, 139 U. S. 417, but affirmed on this point.

[2] *Ibid.* 139 U. S. 417.

[3] Kansas City Hotel Co. *v.* Hunt, 57 Mo. 126, 129. See also Pullman *v.* Upton, 96 U. S. 328.

[4] Kansas Hotel Co. *v.* Hunt, 57 Mo. 126, 129. Compare with Methodist Episcopal Church *v.* Pickett, 19 N. Y. 486.

of a corporation may be validated by an acquiescence of the shareholders in such a sense that a shareholder will not be allowed, after the insolvency of the corporation, when proceeded against by its assignee in bankruptcy to collect what remains due upon his subscription, to set up the invalidity of the increase of capital stock or of a reorganization of the company, where that has taken place.[1] When, therefore, a shareholder was thus sued and his defense was that the proceedings to reorganize the company after it had previously become insolvent and to transfer its charter and to increase its capital stock had been taken by the directors without authority of the shareholders, the defense was held unavailing, on the ground of a subsequent acquiescence and ratification by the defendant, by Mr. District Judge Withey, who stated his conclusion of law as follows: "When the legislature, in 1869, granted authority to existing insurance companies to increase their stock upon taking certain proceedings, and persons acting under color of authority took proceedings and attempted compliance with the law, and in pursuance of those proceedings actually issued additional stock, claiming to have obtained the right so to do, obtained control of the corporation affairs, and launched its new scheme, — then, as between the purchasers and holders of such new stock and the corporation or its creditors, the shareholders are estopped from denying the regularity of the proceedings to increase the stock, and from denying the validity of the stock so issued."[2]

§ 2087. **Effect on the Liability of Shareholders.** — Where the capital stock of the corporation is increased, the general effect upon the liability of shareholders is the same as in the case of an original subscription or purchase.[3] If the increase takes place under such circumstances that the shares are paid for in money or in money's worth, the shareholders who receive them in distribution, or by way of subscription or purchase, cannot be made liable to creditors in respect of them, except under a statute imposing upon shareholders a superadded individual liability.

[1] Railway Co. *v.* Allerton, 18 Wall. (U. S) 233; *s. c.* 10 Myer Fed. Dec., § 134; Clarke *v.* Thomas, 34 Ohio St. 46.

[2] Upton *v.* Jackson, 1 Flipp. (U. S.) 413; 10 Myer Fed. Dec., §§ 137, 138, 139.

[3] *Ante*, § 1600.

If, on the other hand, they have not been paid for within the principles elsewhere stated,[1] the shareholder is liable to pay for them when called upon to do so by creditors of the corporation or by their representative.[2] Nor will mere irregularities in such increase render the shareholders individually liable to creditors in respect of the new shares.[3] But if the new issue is wholly void, as where the corporation has filled up its capital and exhausted its power to issue new shares, then there can be no recovery against the taker of them by the corporation,[4] and it would seem not by creditors. But the fact of the corporation having issued to others shares of its stock in excess of its power does not constitute a defense to a shareholder whose shares are valid, when sued by the corporation for assessments: it is enough that the corporation has not disabled itself from complying with its contract with him by issuing to him his certificates when he shall have paid the purchase money.[5]

§ 2088. **Authorized Increase will not Release Stockholders.** — When a corporation is authorized by its charter to increase its capital stock, the power to increase becomes, so to speak, a part of the contract of subscription, and its exercise will be binding on the stockholder, whether or not he assents thereto. The common law rule[6] that any material alteration in the charter of a corporation, without the consent of a stockholder, relieves him from liability on his stock subscription, does not apply to such a case.[7]

§ 2089. **Liability where the Increase is Cancelled.** — Nor will there be any liability to creditors on the part of the takers of the new shares where the increase is cancelled and the new shares called in before the rights of creditors attach. This principle, undoubtedly true in its proper application, has received

[1] *Ante*, § 1562, *et seq.*

[2] Recognized in Coit *v.* Gold Amalgamating Co., 119 U. S. 343; and in Handley *v.* Stutz, 139 U. S. 417, but the principle not applied in either of these cases.

[3] See, by way of analogy, *ante*, § 224, *et seq.*, and § 1958.

[4] Oler *v.* Baltimore &c. R. Co., 41 Md. 583.

[5] *Ibid.*

[6] *Ante*, §§ 66, 1267, *et seq.*

[7] Port Edwards &c. R. Co. *v.* Arpin, 80 Wis. 214; *s. c.* 49 N. W. Rep. 828.

an application of doubtful soundness in a case in the Supreme Court of the United States, where the facts were that a corporation, having purchased certain property, made a large increase of its capital stock, issuing a part of the new stock in payment of the property; but a larger part to the holders of the original stock. Afterwards the increase was cancelled, the outstanding shares called in, and the capital reduced to its original amount, nothing having been done in the meantime to enlarge the liabilities of the company. It was held that a creditor of the company who was fully aware of the increase and its object, and could have placed no reliance upon the supposed paid-up capital on the increased shares, had no cause of complaint by reason of their subsequent recall, and could not compel the stockholders to pay in the amount.[1]

§ 2090. **Statutory Individual Liability.** — A statutory individual liability of shareholders attaches to them as well in respect of new shares issued to them on an increase of the stock of the corporation, as to their original shares, — as, for instance, a statutory liability for the debts contracted by the corporation prior to the time when the capital stock is paid in. Here if there is an increase and debts are contracted before it is paid in, the share-takers will be liable for such debts.[2] So, too, of a liability imposed by statute upon stockholders for failure to file the proper certificate of payment upon an increase of its capital stock. But such liability is limited to the holders of the increased stock.[3]

§ 2091. **Doctrine that Share-Taker Who Takes at Less than Par is Liable only to Subsequent Creditors.** — The Supreme Court of the United States, in several recent decisions, has not only departed from its previous conceptions, but from the conceptions of nearly all authoritative courts, English and American. In one of its latest decisions it holds, reversing the court below,[4] that where a stockholder in a

[1] Coit *v.* Gold Amalgamating Co., 119 U. S. 343; *s. c.* 7 Sup. Ct. Rep. 231.

[2] Booth *v.* Campbell, 37 Md. 522.

[3] Veeder *v.* Mudgett, 95 N. Y. 295; Griffith *v.* Greene, 129 N. Y. 517; *s. c.* 29 N. E. Rep. 838.

[4] Reversing Stutz *v.* Handley, 41 Fed. Rep. 531.

corporation, who assents to an increase of the capital stock and to a gratuitous distribution of it among the shareholders, receives such stock as full paid stock, an obligation arises to pay for it to creditors whose debts are subsequent to the authorization of the increase, but that this equity does not exist in favor of a creditor whose debt was contracted prior to such authorization.[1] This, so far as the writer knows, is the first authoritative case where it has been held that it makes a difference in respect of the obligation of a shareholder to pay for his shares either in money or in money's worth, whether the creditor becomes such before or after the shares were issued.

§ 2092. New Doctrine that a Corporation can Increase its Capital and Sell the New Shares at their Market Value. — The Supreme Court of the United States decided, in the year 1891, that an active corporation, which desires to raise means for the prosecution of its business, has the power to increase its capital stock and to sell its new shares on the market for the best price it can get; and that, if it gets less than par, creditors cannot compel the share-takers to pay the residue after the company becomes insolvent.[2] A more unfortunate decision has not been made by that court, or by any other court, on the subject of the liability of shareholders. What is more to be regretted is that only two of the judges of the court dissented, the Chief Justice and Mr. Justice Lamar; but they put their dissent in such language as to show that the new doctrine will not pass without challenge.[3] The court say: "We think that an active

[1] Handley *v.* Stutz, 139 U. S. 417, 428, 435; citing First National Bank *v.* Gustin &c. Co., 42 Minn. 327; *s. c.* 23 Am. St. Rep. 327; 44 N. W. Rep. 198; 2 Mor. Corp., §§ 832–3; Coit *v.* N. C. Gold Amalgamating Co., 14 Fed. Rep. 12.

[2] Handley *v.* Stutz, 139 U. S. 417; reversing *s. c. sub nom.* Stutz *v.* Handley, 41 Fed. Rep. 531.

[3] The dissenting opinion, written by Mr. Chief Justice Fuller, is as follows: "I dissent from the conclusion of the court in respect of the stock received by the subscribers to the bonds. That stock was not paid for in money or money's worth, or issued in payment of debts due from the company, or purchased at sale upon the market. It was a mere bonus, thrown in with the bonds as furnishing the inducement to the bond subscription, of larger control over the corporation, and of possible gain without expenditure. Becoming secured creditors through the bonds, the subscribers increased their power through the stock. In my view, there-

corporation may, for the purpose of paying its debts, and obtaining money for the successful prosecution of its business, issue its stock and dispose of it for the best price that can be obtained."[1] 1. Not a single reason can be urged for according this power to a corporation after it becomes "active," which could not be urged in favor of according it to a corporation before it becomes active, — that is, when it is first organized. There may be so little confidence in the venture, that it may be just as necessary, in order to induce the requisite capital to come into it, to sell its shares at less than par, or to give them away as a *bonus* to takers of its bonds, as was done in the case on which we are now commenting, and as was done in order to raise funds to complete the St. Louis bridge, as seen by cases already examined.[2] 2. But this distinction ceases to be material; since all our State corporation laws allow corporations to raise such a large capital that, under the operation of this decision, any mining, manufacturing or other corporation can now organize with a small capital and become "active," and then increase its capital stock and sell new shares on the market "for the best price that can be obtained;" by this process they can dispose of nine-tenths of the shares of their capital stock at one-tenth of its par value, or even at a greater disparity. This decision, if valid, will therefore work a complete destruction of the doctrine that shares of capital stock can only be paid for in money or in money's worth, and that the capital stock of a corporation is a trust fund for its creditors; and verbal repetitions of these salutary doctrines by a court which can so hold, become either unnecessary or meaningless expressions. 3. But this decision proceeds in the very face of the statute law of Kentucky, under which the rights in controversy arose, it being a Kentucky corporation. That statute,

was no actual payment for the stock, and to treat it as paid up, is to sanction an arrangement to relieve those who would reap the benefit derived from the possession of the stock, in the event of the success, from liability for the consequences, in the event of the failure, of the enterprise. When the capital stock of a corporation has become impaired, or the business in which it has engaged has proven so unremunerative as to call for a change, creditors at large may well demand that experiments at rehabilitation should not be conducted at their risk." *Ibid.*, p. 438.

[1] *Ibid.*, p. 435; citing to the proposition Stein *v.* Howard, 65 Cal. 616.

[2] *Ante*, § 1588, *et seq.*

as quoted in the opinion of the Supreme Court of the United States,[1] reads that nothing in the act conferring corporate franchises, or permitting the organization of corporations, "shall exempt the stockholders of any corporation from individual liability to the amount of the unpaid installments of stock owned by them."[2] Such statutes are properly construed to mean that the exemption from individual liability of partners enjoyed by the members of a corporation is a *privilege or franchise*, which is granted only on the condition of their paying for their shares in full, and that, to the extent to which they have not paid them in full, they do not enjoy the privilege. 4. In the light of such a decision the well-known rule that grants of corporate privileges and franchises are to be construed strictly against the grantees becomes a meaningless farce; every doubt is yielded to the corporate manipulator and fixer. 5. While the States, as elsewhere shown, are endeavoring to prevent fictitious increases of the capital stock of corporations, by stringent constitutional and statutory provisions, the highest national court is thus letting down all safeguards and debauching all legal conceptions on the subject.

§ **2093. Increasing the Capital by Issuing Preference Shares.**—If a corporation is really under the necessity of raising more money, it can reach the result aimed at in the case under which the foregoing decision arose, by issuing *preference shares*, where that is permitted by the governing statute, and even by providing that the takers or holders of these preference shares shall receive a *bonus* out of the assets of the company before ordinary dividends are paid. These shares, being issued at their par value, do not create an inflated capital; they in no way affect unfavorably the rights of creditors, but their only effect is to give certain shareholders a preference over the others in the distribution of profits when there are any. To illustrate from an English case: A company having power to increase its capital to such amount and upon such terms, and either with or without special privileges or preferences to the holders of the shares in such increased capital, as they should deem expedient,

[1] 139 U. S. at p. 427.

[2] Gen. Stats. Ky., ch. 56, § 14.

raised further capital by the issuance of preference shares entitled to a preferential interest of ten per cent. per annum; the amount of such shares to be repaid on six months' notice with twenty-five per cent. bonus, such payment of interest, repayment and bonus to take place before any dividend, interest, or other money was payable to the original shareholders. The company was wound up, and after payment of debts there remained a surplus for distribution. It was held that the company had conferred a preference as to capital, as well as dividend, upon the new shareholders, and that they were entitled to the surplus assets in priority to the original shareholders.[1]

§ 2094. **New Stock to be Distributed Ratably among Existing Stockholders.** — Where the corporation increases its capital stock or declares and issues what is sometimes called a stock dividend, the new stock must be distributed ratably among the subscribers to the old stock, or else sold to create a fund which inures to the common benefit. Each stockholder, it has been held, has a right to the opportunity to subscribe for and take the new or increased stock in proportion to the old stock held by him; so that a vote at a stockholders' meeting, directing the new stock to be sold, without giving to each stockholder such an opportunity, is void as to any dissenting stockholder.[2] Some observations of the court in support of this conclusion deserve to be quoted. Gilfillan, C. J., said: "When the proposition that a corporation is trustee of the corporate property, for the benefit of the stockholders, in proportion to the stock held by them, is admitted (and we find no well considered case which denies it), it covers as well the power to issue new stock as any other franchise or property which may be of value, held by the corporation. The value of that power, where it has an actual value, is given to it by the property acquired and the business built up with the money paid in by the subsisting stockholders. It happens not infrequently that corporations, instead of distributing their profits in the way of dividends to stockholders, accumulate them till a large surplus is on hand. No one would

[1] Re Bangor &c. Slate &c. Co., L. R. 20 Eq. 59.

[2] Jones *v.* Morrison, 31 Minn. 140, 152; State *v.* Smith, 48 Vt. 266; Gray *v.* Portland Bank, 3 Mass. 364; *s. c.* 3 Am. Dec. 156.

deny that, in such case, each stockholder has an interest in the surplus which the courts will protect. No one would claim that the officers, directors, or majority of the stockholders, without the consent of all, could give away the surplus, or devote it to any other than the general purposes of the corporation. But when new stock is issued, each share of it has an interest in the surplus equal to that pertaining to each share of the original stock; and if the corporation, either through the officers, directors, or a majority of stockholders, may dispose of the new stock to whomsoever it will at whatever price it may fix, then it has the power to diminish the value of each share of old stock, by letting in other parties to an equal interest in the surplus, and in the good will or value of the established business."[1]

§ 2095. Charter Vesting Directors with a Discretion as to the Distribution of New Stock. — In Indiana, under a charter providing that the directors shall make by-laws "for the management and disposition of the stock of the company, and that the directors" "shall have power to increase the stock of said company to $200,000, on such terms and conditions, and in such manner as to them shall seem best," — it was held, that the existing stockholders had no exclusive right to subscribe for the increased stock, in amounts proportionate to the amounts they then held of the original stock, but that the directors might allot it in such manner as they should regard as most conducive to the interests of the company.[2]

§ 2096. Stock Issued without Giving Other Stockholders an Opportunity of Pro Rata Subscription cannot be Voted. — Where a company was organized with an authorized capital of $5,000, of which only $1,000 had been subscribed, and upon the approach of

[1] Jones *v.* Morrison, 31 Minn. 140, 152. In this case the court follow the rule laid down in Gray *v.* Portland Bank, 3 Mass. 364; *s. c.* 3 Am. Dec. 156. They cite the following authorities as supporting the same principle: Mor. Priv. Corp., §§ 349, 350; Ang. & A. Corp., §§ 554, 555; Field Corp., § 124; State *v.* Franklin Bank, 10 Oh. 91; Eidman *v.* Bowman, 58 Ill. 444; *s. c.* 11 Am. Rep. 90; Miller *v.* Illinois Cent. R. Co., 24 Barb. (N. Y.) 312; Bank *v.* Reese, 26 Pa. St. 143; Reese *v.* Bank, 31 Pa. St. 78; *s. c.* 72 Am. Dec. 726; Atkins *v.* Albree, 12 Allen (Mass.) 359; State *v.* Smith, 48 Vt. 266; Jones *v.* Terre Haute &c. R. Co., 57 N. Y. 196; Taylor *v.* Miami Exporting Co., 5 Oh. 162; *s. c.* 22 Am. Dec. 785; Peabody *v.* Flint, 6 Allen (Mass.), 52; Dousman *v.* Wisconsin &c. Co., 40 Wis. 418.

[2] Ohio Ins. Co. *v.* Nunnemacher, 15 Ind. 294.

an election one of the stockholders, without any corporate action for the increase of stock, induced the secretary to receive a draft from him in payment of the additional stock which might be issued by the corporation, — it was held that such transactions were illegal, and that a board of directors elected by such votes would be restrained by injunction from going into office and from taking possession of the corporate property.[1]

§ 2097. Liability of Corporation to Stockholder for Refusing so to Distribute.— An early case in Massachusetts holds that a stockholder in a bank that is authorized to commence business with one amount of stock, and to increase the amount afterwards, is entitled to subscribe for and hold the additional stock in proportion to his original shares; and the bank is liable to him, if its officers, or the corporation, refuse to allow him thus to subscribe therefor; and the measure of damages will be the excess of the market value above the par value of the number of shares to which he was entitled, with interest on such excess.[2]

§ 2098. Enjoined from Charging Stockholders a Bonus.— From this principle it also follows that where there is a statute permitting corporations to increase their capital stock by increasing the number of their shares, which shares are to be allotted *pro rata* to the stockholders according to their respective interests, it is not competent for the corporation to charge a *bonus* to the shareholders who receive the new shares in distribution, and that equity should enjoin the company from refusing to allow a stockholder to receive his allotment at par without paying a bonus.[3]

§ 2099. But Stockholder Paying Bonus cannot Recover It from the Corporation.— But on grounds which do not appear to be consonant with sound principle, it has been held by the same court that where the corporation does demand of its shareholders such a *bonus* for the privilege of subscribing to its new

[1] Humboldt Driving Park Asso. *v.* Stevens, 34 Neb. 528; *s. c.* 33 Am. St. Rep. 654; 52 N. W. Rep. 568.

[2] Gray *v.* Portland Bank, 3 Mass. 364; *s. c.* 3 Am. Dec. 156.

[3] Cunningham's Appeal, 108 Pa. St. 546; Paxson, J., dissenting as to the remedy in equity.

shares, and the *bonus* is paid by the shareholder, he cannot recover it back, although he paid it under protest,— the theory of the court being that the denial of the stockholder's right to the new shares does not constitute *duress*, because, after a tender, he may sue for and recover the market value of the stock and with this sum buy other shares.[1]

[1] De la Cuesta *v.* Insurance Co., 136 Pa. St. 62, 658; *s. c.* 20 Atl. Rep. 505; 26 W. N. C. 337; 47 Phila. Leg. Int. 466; 9 L. R. A. 631; Sterrett and Clark, JJ., dissenting. The court distinguish between the two cases, on the ground that the former was a proceeding in equity which left the defendant company the option either to withhold the issue of new stock altogether, or to issue it at par; while the last case cited was simply a suit to recover money voluntarily paid, in which the plaintiff, while protesting under the contract, or against being required to contract, seeks rights under it. This is a narrow view; for the right which he seeks does not depend upon the contract at all, but is really incident to his position as stockholder, and the contract to pay a *bonus* is an unauthorized condition imposed by the managers. The principle on which many courts still proceed in refusing actions to recover back money paid under *duress of property* are oppressive and discreditable relics of the rude barbarism and injustice of the common law; and this decision seems to be one of them. The true principle is stated by a recent able contributor to the *American Law Review* (Prof. John H. Wigmore of the University of Tokyo, Japan) as follows: *Where the defendant requires money or some other benefit from the plaintiff as the price of doing or refraining from doing that which he has no right to do or refrain from doing, and the plaintiff is compelled by the risk of loss to confer the benefit requested, the benefit so conferred or its equivalent may be recovered.* The following illustrations are given by the learned author: The plaintiff, a mortgagor, pays to the mortgagee, the principal and interest of the debt and receives a reconveyance, but the mortgagee's attorney refuses to give up the title deeds except upon payment of his bill of costs. No such lien exists, and the plaintiff may recover the sum so paid to obtain the title deeds. Wakefield *v.* Newborn, 6 Q. B. 276. The defendant, who has bought mining property from the plaintiff under a quit-claim deed, is the officer of a bank in which money of the plaintiff is deposited. The defendant has bought up a claim against the property received from the plaintiff and refuses to allow the withdrawal of the plaintiff's deposit unless subject to a deduction for the sum paid for this claim. The plaintiff accedes and makes a settlement, but may recover the sum so deducted. Adams *v.* Scheffer, 11 Colo. 15; *s. c.* 7 Am. St. Rep. 202. The defendant, a railroad company, carries the plaintiff's goods and refuses to deliver them except on payment of $100, the proper charge being $50. The plaintiff may recover the excess paid in order to obtain the goods. The defendant, a pawnbroker, refuses to deliver to the plaintiff his pledged goods, except on payment of $50. The proper charge is $20. The plaintiff pays the excess to obtain the property, but may recover it. Astley *v.* Reynolds, 2 Stra. 915. The defendants, members of a labor

§ 2100. Rule does not Apply to Shares of Original Stock Bought in.— The foregoing rule, which requires a ratable distribution of the new shares where the capital is increased, does not apply to the case where the corporation buys in the shares of its own *original stock* and holds them as assets or sells them for the payment of its liabilities or for the general benefit.[1]

§ 2101. Imposing a Limit as to Time when New Shares Taken.— But the corporation must obviously be allowed to have the power of imposing a reasonable limit as to the time within which its shareholders shall exercise their option of becoming subscribers to the new shares, and of forfeiting the privilege where the option is not exercised within the time limited. Accordingly, where the charter of a corporation provided for sixty days notice of an authorization of any increase of the capital stock, within which time any stockholder might have the privilege of taking additional shares, it was held that any stockholder not applying and tendering payment within such time would forfeit the privilege.[2]

§ 2102. Remedy of Corporation where Shareholder Fails to take His Proportion. — When an *increase* of stock by a mining company has been determined on, in the manner provided by the statute,[3] and the stockholders decline to pay for part of the stock, the authority of the company to dispose of such stock is complete, and the agreement to take shares may be enforced by action, although the whole of the increased stock is never taken.[4]

association, impose a so-called fine of $500 upon the plaintiff, an employer, and threaten to persuade a number of his hands to leave his employment, if the fine is not paid. If the act of persuading the workmen to leave is an unlawful one, the money so paid may be recovered. See Carew *v.* Rutherford, 106 Mass. 1; *s. c.* 8 Am. Rep. 287. What difference is there in principle, between the case of a carrier or pawnbroker refusing to deliver the thing bailed except on payment of an improper charge, and the case of a corporation refusing to issue its new shares to its members, who are entitled to them under a statute, except on payment of a bonus which it has no right to exact?

[1] State *v.* Smith, 48 Vt. 266.

[2] Hart *v.* St. Charles Street R. Co., 30 La. An., Part I. 758. (Egan, J., dissented.)

[3] Swan & S. Ohio Stat. 237.

[4] Clarke *v.* Thomas, 34 Ohio St. 46.

§ 2103. **Right of Rescission where all of the New Shares are not Taken.**— It is elsewhere shown that where the governing statute, articles of association, or other governing instrument prescribes that a certain capital shall be raised, and subscriptions are taken with the view of raising it, no subscription is binding until the entire capital so attempted to be raised has been subscribed for in good faith by solvent persons capable of answering their calls.[1] This principle can have but a limited application to subscriptions to new shares in the case of an increase of the capital of a going corporation.[2] Thus, the Supreme Court of Louisiana holds that an original stockholder who signs without qualification a subscription for new stock to increase the original stock is not entitled to cancellation of his subscription, and repayment of the amount paid in, on the ground that all the new shares were not subscribed for. The court reason that, in the absence of any stipulation or limitation to the contrary, his subscription is not contingent or dependent upon the taking of all the shares, but is absolute, and binds him accordingly.[3] And in a Massachusetts case, where a railroad corporation voted to issue six hundred *additional shares*, and to allow each stockholder to take one new share for every two shares already held by him, provided he should, by a certain day, subscribe therefor, and pay a part of the price, and give notes for the remainder, it was held that there was no *implied condition* that the whole number of six hundred new shares should be issued; and that the failure of the corporation to issue that number was no ground for maintaining an action by a stockholder to recover back money so paid by him, nor for defeating an action on notes so given by him.[4] So, too, where the previous proceedings, looking to an increase of the capital stock of a *national bank*, have been regular and all that is required, and a stockholder subscribes to his proportionate part of the increase and pays his subscription, the law does not attach to the subscription the condition that it shall be void unless the whole authorized increase is subscribed, — although it is conceded that

[1] *Ante*, § 1235, *et seq.*

[2] Clarke *v.* Thomas, 34 Oh. St. 46. See also Minor *v.* Mechanics' Bank, 1 Pet. (U. S.) 46.

[3] Avegne *v.* Citizens' Bank, 40 La. An. 799; *s. c.* 5 South Rep. 537.

[4] Nutter *v.* Lexington &c. R. Co., 6 Gray (Mass.), 85.

there may be cases in which equity would interfere to protect him in case of a material deficiency. Nor does the provision of § 5142 Rev. Stat. U. S. change this principle. That provision, which is to the effect that no increase of capital stock in a national bank shall be valid until the whole amount of the increase shall be paid in, and the comptroller of the currency notified and his consent obtained, is construed as having been intended to secure the actual cash payment of the subscriptions made and to prevent the watering of stock; but not to invalidate *bona fide* subscriptions actually made and paid in.[1]

§ 2104. Power of Corporation to Rescind Vote to Increase. — We have elsewhere seen a conflict of judicial opinion on the question whether a corporation can recall a *dividend* after having declared it.[2] Analogous to this is the question whether it can recall a *stock dividend* after having declared such a dividend. But where the corporation votes to increase its capital for a special object, the intention being to raise new capital for which its shareholders may or may not subscribe, it is obvious that this principle can have no just application, where the stockholder has parted with nothing and has not changed his position on the faith of the vote in any way. This statement may perhaps be illustrated by a case where a corporation voted to increase its capital stock 2,000 shares out of its surplus earnings. The increase was for a special object, though not so stated in the vote, and the object immediately thereafter failed, whereupon the vote was rescinded before action taken under the former vote. A stockholder, with knowledge of the foregoing facts, a year later brought a suit in equity to compel an issue to him of stock upon the basis of the vote before mentioned. Important transactions had intervened, and stock changed hands on the basis of the unincreased capital. It was held that the mere vote to increase gave the petitioner no vested interest, that the company had power to rescind its vote, and that the

[1] Aspinwall *v.* Butler, 133 U. S. 595. See also Delano *v.* Butler, 118 U. S. 634; Pacific Nat. Bank *v.* Eaton, 141 U. S. 227; *s. c.* 35 L. ed. 702; 10 Rail. & Corp. L. J. 132; 11 Sup. Ct. Rep. 984; Thayer *v.* Butler, 141 U. S. 234; *s. c.* 35 L. ed. 711; 11 Sup. Ct. Rep. 987.

[2] *Post*, § 2131, *et seq.*

petitioner, by his laches and acquiescence for so long a time, had lost whatever equity he might have had.[1]

§ 2105. Constitutional Prohibitions of the Fictitious Increase of Capital Stock. — Constitutional provisions exist in many of the States restraining the fictitious increase of the capital stock of corporations. These, so far as the writer has come across them, are as follows: "No corporation shall issue stock or bonds, except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. The stock and bonded indebtedness of corporations shall not be increased except in pursuance of general laws, nor without the consent of the persons holding the larger amount in value of stock, first obtained at a meeting to be held after thirty days' notice given in pursuance of law."[2] - - - - "No private corporation shall issue stocks or bonds, except for money or property actually received or labor done, and all fictitious increase of stock or indebtedness shall be void; nor shall the stock or bonded indebtedness of any private corporation be increased except in pursuance of general laws, nor until the consent of the persons holding the larger amount in value of stock shall be obtained at a meeting held after notice given, for a period of not less than sixty days, in pursuance of law."[3] - - - - "No corporation shall issue stock or bonds, except for money paid, labor done, or property actually received, and all fictitious increase of stock or indebtedness shall be void. The stock and bonded indebtedness of corporations shall not be increased except in pursuance of general law, nor without the consent of the persons holding the larger amount in value of the stock, at a meeting called for that purpose, giving sixty days' public notice as may be provided by law."[4] - - - - "No corporation shall issue stocks or bonds, except for labor done, services performed, or money or property actually received, and all fictitious increase of stock and indebtedness shall be void. The stock of corporations shall not be increased except in pursuance of general law, nor without the consent of the persons holding a majority of the stock, first obtained at a meeting held after at least thirty days' notice given in pursuance of law."[5] - - - - "No

[1] Terry v. Eagle Lock Co., 47 Conn. 141.

[2] Ala. Const. of 1875, art. 14, § 6.

[3] Ark. Const. of 1874, art. 12, § 8.

[4] Cal. Const. of 1879, art. 12, § 11. It has been held that the effect of this provision was to annul section 359 of the Civil Code, providing for an increase of stock, through the medium of a meeting, or by the written assent of the holders of three-fourths of the capital stock of the corporation. Ewing v. Croville Mining Co., 56 Cal. 649.

[5] Col. Const. of 1876, art. 15, § 9.

corporation shall issue stock or bonds, except for money paid, labor done, or property actually received, and all fictitious increase of stock or indebtedness shall be void. The stock and bonded indebtedness of corporations shall not be increased, except in pursuance of general law, nor without the consent of the persons holding the larger amount in value of the stock, first obtained at a meeting called for the purpose, first giving sixty days' public notice, as may be provided by law."[1] - - - - "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. The stock and indebtedness of corporations shall not be increased except in pursuance of the general law, nor without the consent of the persons holding the larger amount in value of the stock first obtained, at a meeting to be held after sixty days' notice given in pursuance of law."[2] - - - - "No corporation shall issue stock or bonds except for money paid, labor done, or property actually received, and all fictitious increase of stock or indebtedness shall be void."[3]

§ 2106. Statutory Provisions Respecting the Increase of Capital Stock. — Very many statutory provisions on the subject of the increase of the stock of corporations and of "stock watering" exist. As these provisions would, if collected and printed, occupy a great deal of space, and as they are constantly being amended, the author has made no attempt to collect them; but merely notes a few that have fallen under his eye. By the statute of Wisconsin a *two-thirds vote* of stockholders at an annual meeting, or special meeting called for that purpose, may authorize an increase of stock.[4] - - - - In Indiana the right of a corporation to increase or decrease stock is vested in the board of *directors*, and requires a *two-thirds vote* of same.[5] - - - - The provisions of the statute of Kansas in relation to the increase of the capital stock of corporations by vote of the stockholders thereof[6] has been amended, by requiring that such increase, when above three times the original capital, be paid up in cash.[7] - - - - The statute of Pennsylvania has been amended so as to require certain corporations, upon increasing their capital stock, to pay into the State treasury a specified *bonus*.[8] - - - - In New Jersey the power of increase is vested in

[1] Mo. Const. of 1875, art. 12, § 8.

[2] Penn. Const. of 1873, art. 16, § 7.

[3] Tex. Const. of 1876, art. 12, § 6.

[4] Rev. Stat. Wis. 1878, § 1826.

[5] Rev. Stat. Ind. (Myers & Co.), An. ed. 1888, Vol. 2, ch. 19, § 3021e.

[6] Kan. Laws 1883, c. 47, sec. 1.

[7] Kan. Act March 11, 1887; Laws Kan. 1887, ch. 117, p. 172.

[8] Penn. Laws 1889, No. 125.

the board of directors, provided that the corporation is required to file in the office of the secretary of State a certificate setting forth the amount of the proposed increase and the number of shares into which it is to be divided, with the assent in writing of stockholders owning two-thirds of the existing capital stock.[1]

§ 2107. Limitations of Amount of Capital Stock. — Statutes exist in many of the States limiting the amount of the capital stock which corporations may possess. Thus, a recent amended act of North Carolina, applicable to all corporations except railroad, banking and insurance companies, limits the amount of capital stock which all such companies may have, to one million dollars.[2] Such legislation voices the reviving fear of corporations. The underlying motive is probably to prevent the formation of those great companies whose object and tendency are to suppress competition and engross the market in a particular commodity, popularly known as "trusts."

§ 2108. Decisions under Particular Statutes. — Under the statute of Alabama prohibiting "all fictitious increase" of corporate stock, a newspaper corporation with a paid-up capital of $10,000 may not double its stock and distribute the new stock as a stock dividend, on a showing merely that its capital "has been invested in property which has more than *doubled in value*, and is now worth $20,000 over and above all liabilities."[3] - - - - The increase of the capital stock of a corporation, and the issue of additional shares, to be sold at a price less than the nominal value of the stock, to supply a fund for the actual use of the corporation, is not a "fictitious increase" of the stock, within the meaning of the prohibitory clause of the constitution of California.[4]

§ 2109. [Virginia] Preferred Stock.—Under a statute of Virginia[5] authorizing a corporation to increase its capital stock "to such extent as

[1] Laws N. J. 1889 c. 105, p. 155.

[2] N. C. Laws 1889, ch. 170, p. 143.

[3] Fitzpatrick *v.* Dispatch Publishing Co., 83 Ala. 604; *s. c.* 19 Am. & Eng. Corp. Cas. 423; 2 South. Rep. 727; 2 Rail & Corp. L. J. 351. There is a discussion of "stock watering" by E. L. Andrews, Esq., in 21 Am. Law Review, 696, but without citing cases.

[4] Stein *v.* Howard, 65 Cal. 616. Requisites of the evidence of notice to the stockholders of a manufacturing corporation, of an *increase* of stock, under N. Y. Laws 1848, ch. 40, secs. 20–22, also of the certificate thereof and its acknowledgment: Cuykendall *v.* Douglas, 19 Hun (N. Y.), 577.

[5] Va. Acts of 1865–66, p. 332, ch. 210.

may be requisite to enable them to liquidate all arrears of debts, interest and dividends, * * * and to make such portion of the increased capital stock as they may deem advisable a "guaranteed stock," on which dividends of not exceeding seven per cent. per annum may be guaranteed," — it was held that the stock issued was *guaranteed capital;* but that as to any excess of dividends to which the stock may be entitled beyond the seven per cent., it must stand on the same footing with the common stock.[1]

§ 2110. [Missouri] Cannot be Increased except in Pursuance of Law: Notice must be Published. — The constitution of Missouri provides that "the stock and bonded indebtedness of corporations shall not be increased, except in pursuance of general law, nor without the consent of the persons holding the larger amount in value of the stock, first obtained at a meeting called for that purpose, first giving sixty days' public notice as may be provided by law.[2] In pursuance of this constitutional provision the legislature of Missouri enacted as follows: "Whenever any corporation shall desire to call a meeting of the stockholders, for the purpose of availing itself of the privileges and provisions of this article, or for increasing or diminishing the amount of its capital stock, * * * it shall be the duty of the directors to publish a notice, signed by at least a majority of them, in a newspaper in the county, * * * at least sixty days, and to deposit a written or printed copy thereof in the post-office, postage prepaid, addressed to each stockholder, at his usual place of residence, at least sixty days previous to the day fixed upon for holding such meeting, specifying the object of the meeting, the time and place, when and where such meeting shall be held, and the amount to which it shall be extended or changed. * * * The notice provided for in this section shall be published at least once a week, and the first publication must be at least sixty days before the day of such meeting."[3] The succeeding section provides for the filing with the secretary of State of a certified copy of the recorded proceedings at the meeting, "showing a compliance with the provisions of this article;" whereupon it is made his duty "to issue a certificate that such corporation has complied with the law made and provided for the increase of its capital stock * * * and the amount to which such capital stock is increased." The interpretation of the statute first above cited is, that the notice therein prescribed to be made by publication is intended for the information of the public at large, and that the notice required to be transmitted to the stockholders is intended

[1] Gordon *v.* Richmond &c. R. Co., 78 Va. 501.

[2] Const. Mo., art. 12, § 8.

[3] R. S. Mo. 1879, § 938.

for their benefit. The conclusion was that where the certified copy of the recorded proceedings transmitted to the secretary of State did not show that the notice had been given as required by law, he was not obliged to issue the certificate required by the statute, and would not be compelled to do so by mandamus, although all the stockholders may have attended the meeting and may have unanimously consented to and voted for the increase of the capital stock.[1]

§ 2111. National Banks: Assent of Comptroller of Currency.—The comptroller of the currency has power to assent to an increase of the capital stock of a national bank less than that originally voted by the directors, but equal to the amount actually subscribed and paid for by the shareholders under that vote; and where the entire amount cannot be raised, the amount can be reduced by the concurrent action of the association and the comptroller of the currency.[2]

Article II. Reducing Capital Stock.

§ 2114. Can only be Diminished in the Manner Prescribed by Statute.—A reduction of the capital stock of a corporation can only take place when authorized by law and in the manner prescribed by law. Statutes exist in several jurisdictions providing that any change in the amount of the capital stock of a corporation shall be made at a shareholders' meeting called for

[1] State ex rel. *v.* McGrath, 86 Mo. 239. The document transmitted to the secretary of State recited: "Notice of the meeting and the purpose thereof having been duly given and received by said stockholders," etc.

[2] Aspinwall *v.* Butler, 133 U. S. 595, 609; Aspinwall *v.* Delano, 118 U. S. 649.

that purpose, upon a notice specifying the object of the meeting and the proposed change, which notice shall be published in a prescribed manner.[1] Commenting upon such a statute, it has been said: "The publicity required in this proceeding is for the purpose — in part, at least, of advising the public dealing with the corporation of the proposed change. The requirement of the statute — (1) that the publicly recorded certificate of incorporation shall state the amount of the capital stock, and (2) that any change in the amount thereof shall only be made after extended public notice, — is in direct conflict with the secret contrivance alleged to have been made by Lake and his associates. The decisions uniformly hold that any secret arrangement between the corporation and its shareholders, by which the responsibility of the latter is made less than it appears to be under the articles of incorporation, is void as against creditors.[2]

§ 2115. Reducing by Order of Court under English Companies Act.— By section 11 of the English Companies' Act, 1867, power is lodged in the Chancery Division of the High Court of Justice to confirm a resolution to reduce capital. It is held that this is a discretionary power which the court may exercise, either by confirming the resolution, with or without consideration, or by declining to confirm. One matter to be taken into account is, whether the proposed scheme would work injustice between the different classes of shareholders; if, in the opinion of the court, such would be its effect, it is not the function of the court to impose conditions amounting to an alteration of the scheme, but the proper course to take, if such an alteration is requisite, is simply to refuse to confirm the resolution, leaving it to the company to prepare a new scheme if they should think fit.[3]

§ 2116. Preliminary Expense is not "Lost Capital."— This power to reduce its capital granted by the Companies' Act of 1867, is

[1] See for instance, 2 Comp. Laws Nev. §§ 3401, 3406, 3407, 3408, 3544.

[2] Thompson *v.* Reno Savings Bank, 19 Nev. 103, 112; *s. c.* 3 Am. St. Rep. 797, 800. In support of this the court cite: Allibone *v.* Hager, 46 Pa. St. 48; McHose *v.* Wheeler, 45 Pa. St. 40.

[3] Re Direct Spanish Tel. Co., 34 Ch. Div. 307; *s. c.* 56 L. J. (Ch.) 353; 55 L. T. (N. S.) 804; 35 Week. Rep. 209. For the practice of reducing share capital with the sanction of the court under this statute, see also General Mining Co., Ir. R. 6 Eq. 213. A statement of the practice is made, in condensed form, in Lind. Comp. 5th ed., p. 402, *et seq.* The same author explains the manner of reducing paid-up capital under the Companies' Act, 1880. *Ibid.*, p. 404–5.

explained by the amendatory act of 1877, to be a power "to cancel any lost capital, or capital unrepresented by available assets, or to pay off any capital which may be in excess of the wants of the company."[1] Under this provision on a petition for confirmation it was held that capital properly expended by a company in preliminary expenses, cannot be treated as "lost capital, or capital unrepresented by available assets," so as to entitle the company to reduce its capital by the amount so expended.[2]

§ 2117. **Reduction of "Common Stock," only.** — Where a company, which has issued both common and preferred stock, wishes to reduce the former only, and has provided for such reduction by proper resolution in accordance with the statute, it was held that its action would be sanctioned by the court apart from any reduction of its preference capital.[3]

§ 2118. **When Corporation May be Compelled to Refund to Shareholders the Whole Amount of the Reduction.**— It has been held, moreover, in a case arising under § 5143, Rev. Stats. U. S. respecting national banks, that in case of a reduction where the capital stock remains entirely unimpaired, the corporation cannot retain in its treasury any part of the amount thus released, — that is, the difference between the amount of its capital as originally fixed and paid in and the amount to which it is reduced; but may be compelled to distribute the difference to the shareholders.[4]

§ 2119. **Rights of Shareholder in Respect of His Surrendered Shares.** — It has been held in Indiana, that where shareholders *reduce* the stock to avoid a threatened assessment by the comptroller, rendered necessary by the impairment of the capital by suspended claims, a stockholder cannot, on the amount of these claims being realized, enforce his demands

[1] Companies Act 1877, § 3.

[2] Re Abstainers & General Ins. Co. (1891), 2 Ch. 124.

[3] Re Agricultural Hotel Co. (1891), 1 Ch. 396; (following Re Barrow Hæmatite Steel Co., 39 Ch. Div. 582; Re Quebrada Ry. L. & C. Co., 40 Ch. Div. 363; Re Gatling Gun, Limited, 43 Ch. Div. 628; and Re American Pasteral Co., W. N. (1890), p. 62, and declining to follow Re Union Plate Glass Co., 42 Ch. Div. 513).

[4] Seeley *v.* New York National Exchange Bank, 8 Daly (N. Y.), 400; *s. c.* aff'd, 78 N. Y. 608.

for a part proportionate to the amount of his surrendered stock.[1]

§ 2120. Agreement to Issue Reduced Stock Binding on Company. — An agreement between officers of a corporation and a stockholder thereof, whereby the latter is to surrender his stock, and receive in exchange a less amount of reduced capital stock, is binding upon the company, when the agreement has been sanctioned by it in the proceedings for the reduction of its capital stock, and has been approved by its directors.[2] In such a case the stockholder is not precluded from suing the corporation for stock claimed under the agreement, by reason of a promise by its president, made after the original agreement, and never fulfilled, that if a certain person would confirm plaintiff's claim, — which he did, — the president would give plaintiff an amount of his own stock equal to that claimed.[3]

§ 2121. Issuing Certificates of Indebtedness to Shareholders for their Surrendered Shares. — Under a statute authorizing a reduction of the capital stock of a company, but containing no provisions applicable to the case of a reduction to meet the exigency of an impaired capital, a reduction cannot take the form of distributing the assets of the corporation to the shareholders without retaining enough in hand to answer for its debts secured and unsecured. But where enough is thus retained there seems to be no objection to the corporation issuing certificates of indebtedness to its shareholders to take up their surrendered share certificates; at least the payment of such certificates will not be enjoined at the suit of a stockholder, after the lapse of three years. In a case from which these propositions are culled it appeared that a street railway company reduced its capital stock from $400,000 to $200,000, and issued to stockholders certificates of indebtedness for $200,000. The owners of all but one hundred shares out of four thousand accepted these certificates. The company paid $55,000 of these certificates out of its net earnings. In an action by the plaintiff, who held fifty of the

[1] McCann *v.* First National Bank, 112 Ind. 354.

[2] Abbott *v.* Petersburg Granite Quarrying Co., 17 N. Y. Supp. 140.

[3] *Ibid.*

one hundred shares, to restrain payment of the rest of the certificates, it was held that, assuming that the issue thereof was unauthorized, that did not entitle him to the relief demanded, as it did not appear that their payment would infringe upon the capital, and the holders thereof were entitled to receive any surplus.[1]

§ 2122. **Effect on the Liability of Creditors.**— An act of the legislature authorizing the reduction of the capital stock of a bank to the amount paid in at a certain period will exonerate the shareholder from any liability beyond the amount of the reduced stock, as to creditors who have become such since the reduction.[2] Where the capital stock of a bank has been thus reduced, and a creditor proceeds against its shareholders, it becomes material to show the date at which his debt was contracted,— whether before or after the reduction. The date of the bills of the bank are not evidence upon this point; because, as is well known, such documents are treated as money, and are constantly issued and re-issued as money, and the date is therefore neither evidence of when they were last issued nor when the plaintiff became the holder of them. A subsequent holder of such bills is not vested with the rights of the first holder, so as to make the debt due to him date from the time when they were first issued.[3] His right of action is an original one, accruing to

[1] Strong *v.* Brooklyn Crosstown R. Co., 93 N. Y. 426.

[2] Hepburn *v.* Commissioners, 4 La. An. 87; Palfrey *v.* Paulding, 7 La. An. 363.

[3] Hepburn *v.* Commissioners, 4 La. An. 87; Palfrey *v.* Paulding, 7 La. An. 363. These cases, it is thought, can hardly stand the test of a careful scrutiny. The legislature passes an act in substance exonerating stockholders of banks from future assessments. Of course such an act is void as to previous creditors. Before the passage of the act a bank had put in circulation its notes to the extent, say, of $100,000. These notes necessarily continue to circulate as money, and such are the relations of trade and of society that men must continue to take and pass them. The dishonesty which embodied itself in the act of the legislature has characterized the conduct of the board of directors. When the tangible assets of the bank are all eaten out, and the empty shell is cracked, then there is found an indebtedness of the bank to the public of $100,000, incurred before the passage of the act in question. This indebtedness has never been redeemed; for when a bank receives its own bills, and does not cancel them, but immediately pays them out again as money, this is no redemption. A judicial decision, conceived in no higher spirit

him directly and primarily at the moment when he becomes the bearer of the bills. He is no more affected with the rights or liabilities of an assignee than he would have been had the issue of the bill by the bank been made directly to him in the first place.[1]

than that which animated the legislature, now steps in, and says that the members of the community who unfortunately were caught in the possession of these unredeemed and dishonest securities at the time of the bursting of the shell, have no redress against the shareholders, because the bank, instead of redeeming these notes, *may* have taken them in and passed them out again, as money, since the date of their first issue.

[1] Bullard *v.* Bell, 1 Mason (U. S.), 243.

CHAPTER XXXV.

DIVIDENDS.

ARTICLE I. GENERALLY.

§ 2126. What is a Dividend.— A dividend is that portion of the profits and surplus funds of the corporation which has been actually set apart by a valid resolution of the board of directors, or by the shareholders at a corporate meeting, for distribution among the shareholders according to their respective interests, in such a sense as to become segregated from the property of the corporation, and to become the property of the shareholders distributively.[1]

§ 2127. Not a Debt Until Declared. — A dividend is not a debt until declared, but is merely a right to a proportionate share of the profits of a corporate venture when the same is declared payable, by the board of directors or otherwise, in pursuance of the constating instruments of the company. "A debt," said Mr. Justice Cooley, "is that which one person is bound to pay to another, either presently or at some future period; something which may be the subject of a suit as a debt, and not something to which the party may be entitled as damages in consequence of the failure to perform a duty or keep an engagement. A right to a dividend from the profits of a corporation is no debt until the dividend is declared. Until that time the dividend is only something that may possibly come into existence, but the obligation on the part of the corporation to declare it can not be treated as the dividend itself."[2] To give a practical turn to this principle, a case may be referred to where it was ruled that a statute making directors, in default of filing certain annual reports, personally liable for the *debts* of the corporation, can not be invoked in favor of one who is not a *creditor* of the corporation in any other sense than being the holder of its preferred and guaranteed shares.[3]

§ 2128. Declaration of, Rests in the Discretion of the Directors and not Compelled in Equity.— In nearly all joint-stock corporations organized for pecuniary gain the directors are

[1] King *v.* Paterson &c. R. Co., 29 N. J. L. 82.

[2] Lockhart *v.* Van Alstyne, 31 Mich. 76; *s. c.* 18 Am. Rep. 156; citing Re London India Rubber Co., L. R. 5 Eq. 525. To the same effect see Stevens *v.* South Devon R. Co., 9 Hare, 312; Henry *v.* Great Northern R. Co., 1 De Gex & J. 605; *s. c.* 3 Jur. (N. S.) 1133; Taft *v.* Hartford &c. R. Co., 8 R. I. 310; *s. c.* 5 Am. Rep. 575.

[3] Lockhart *v.* Van Alstyne, *supra.*

the managing and financial agents of the corporation, considered as a unit, and are, in the theory of courts of equity, trustees for the shareholders. The declaration of dividends is generally regarded as resting within the implied scope of their authority, subject, of course, to the rules prescribed by the private instruments of the company, and subject to be overruled or controlled by the shareholders in their constituent capacity. Unless so overruled or controlled, they have authority to declare dividends and to fix the time and place of payment, within such limitations as reason and good faith to the stockholders may require.[1] The *general rule* therefore is that a *common shareholder* has no legal or equitable remedy to *compel* the directors of the company to declare and pay a dividend.[2] The right of a *common shareholder* to invoke judicial interference to compel the declaration of a dividend rests on a different and somewhat lower footing from that of *preferred shareholders*.[3] There is no *contract* between him and the corporation that the corporation shall pay him a dividend under any stated circumstances. The directors, who are generally themselves stockholders, and who therefore presumptively have no interest in impairing and deferring the rights of stockholders, must necessarily be invested with a large discretion in respect of this question, except in cases where their discretion is restrained by the by-laws or other governing instrument. The judges of the courts are not ordinarily expert in the management of the enterprises which are usually undertaken by corporations, and are not well qualified to say, except in plain cases, whether a dividend should or should not be declared and paid. It therefore seems a sound view that the courts will interfere in behalf of a common stockholder, to compel the declaration and payment of a dividend, only in a plain case of *fraud* or *abuse of discretion* on the part

[1] King *v.* Paterson &c. R. Co., 29 N. J. L. 82; Ely *v.* Sprague, 1 Clarke Ch. (N. Y.) 351; Railroad Co. *v.* United States, 99 U. S. 420; Park *v.* Locomotive Works, 40 N. J. Eq. 114; *s. c.* 3 Atl. Rep. 162; Minot *v.* Paine, 99 Mass. 101; Stringe's Case, L. R. 4 Ch. 490; Williams *v.* Telegraph Co., 93 N. Y. 187; Excelsior &c. Co. *v.* Pierce, 90 Cal. 131; *s. c.* 27 Pac. Rep. 44.

[2] Karnes *v.* Rochester &c. R. Co., 4 Abb. Pr. (N. Y.) (N. S.) 107; Hunter *v.* Roberts &c. Co., 83 Mich. 63; *s. c.* 47 N. W. Rep. 131; Am. & Eng. Corp. Cas. 349; 9 Rail. & Corp. L. J. 90; McNab *v.* McNab &c. Man. Co., 41 N. Y. St. Rep. 906; *s. c.* 16 N. Y. Supp. 448. Compare Attorney-General *v.* State Bank, 1 Dev. & Batt. Eq. (N. C.) 545.

[3] As to which see *post*, § 2289.

of directors, and to prevent manifest injustice.[1] In a recent case in Michigan the doctrine is thus stated by Champlin, C. J.: "Courts of equity will not interfere in the management of the directors, unless it is clearly made to appear that they are guilty of fraud or misappropriation of the corporate funds, or refuse to declare a dividend when the corporation has a surplus of net profits which it can, without detriment to its business, divide among its stockholders, and when a refusal to do so would amount to such an abuse of discretion as would constitute a fraud, or breach of that good faith which they are bound to exercise towards the stockholders."[2] Applying this doctrine, it has been held that, although a manufacturing corporation had done a prosperous business, yet where its assets consisted largely of its plant and of notes taken upon long time from its customers in different States, which notes were consequently not available for discount in bank, so that it would be compelled, in order to pay a dividend, either to borrow money or seriously to impair its working capital,—a court of equity would not, at the suit of a stockholder, compel the declaration of a dividend.[3]

§ **2129. Except in Cases of Fraud, Caprice or Abuse.**—A limitation of the rule is indicated by judicial dicta to the effect that equity will not compel the directors of a corporation to declare a dividend, at the suit of a common stockholder, in the absence of proof that they have acted unreasonably, capriciously or fraudulently.[4] But a court of *equity has power*, at the suit of a minority of the stockholders of a corporation, to order a dividend of its assets where the safety or the interest of the minority requires it; and in determining whether to exercise such power in a particular case, the object of the corporation and the situation of its affairs must be taken into consideration.[5]

[1] See as illustrating these views, Karnes *v.* Rochester &c. R. Co., 4 Abb. Pr. (N. Y.) 107.

[2] Hunter *v.* Roberts &c. Co., 83 Mich. 63; *s. c.* 47 N. W. Rep. 131; 31 Am. & Eng. Corp. Cas. 349; 9 Rail. & Corp. L. J. 90.

[3] Hunter *v.* Roberts &c. Co., *supra* (Morse and Cahill, JJ., dissenting).

[4] McNab *v.* McNab Man. Co., 41 N. Y. St. Rep. 916.

[5] Fougeray *v.* Cord, 50 N. J. Eq. 185; *s. c.* 24 Alt. Rep. 499.

§ 2130. Restraining the Declaration of a Dividend.— Where the propriety of declaring a dividend is fairly within the scope of the discretion reposed in the directors by the constating instruments, equity will not lend its aid to restrain the declaration of a dividend at the suit of shareholders. It was accordingly held in the English Court of Appeal that where the act incorporating a company contains no provision that the dividends are to be paid only out of profits, but provides that capital assets are not to be applied for any purpose not within the objects of the company, and the nature of the property is such that, in order to derive a profit, there is necessarily a yearly consumption of part of the capital, — if the directors and company have acted fairly and reasonably, and within the powers conferred by the articles of association, in ascertaining whether a dividend is a division of profits, and not of capital, their discretion will not be interfered with; especially where there is no necessity of setting apart a sum to meet the supposed annual diminution in the value of the property from lapse to time.[1]

§ 2131. Corporation Cannot Appropriate Unpaid Dividends.— It seems that if a dividend has been declared and a fund appropriated to its payment, this fund acquires the character of a *trust fund;* it must therefore be regarded as the property of the shareholders, and cannot be applied by the directors to any purpose not included in their charter or fundamental contract, without the consent of such shareholders.[2] Where, therefore, a company first made a dividend of ten per cent., and, before payment thereof, laid an assessment of ten per cent., payable on the same day, it was held that the corporation was not entitled, as against the subsequent assignee in bankruptcy of a then insolvent stockholder, to take the dividend of the stockholder, without an order from him, in payment of any debt due from him to the corporation, or as a *set-off to the assessment*, or as a charge upon any shares which might afterwards be sold.[3]

[1] Lee *v.* Neuchatel Asphalte Co., 41 Ch. Div. 1; *s. c.* 6 Rail. & Corp. L. J. 266.

[2] Reasoning in March *v.* Eastern R. Co., 43 N. H. 515, 533. The case related to a fund created under a *railroad lease* in lieu of dividends to the stockholders of the lessor company.

[3] Ex parte Winsor, 3 Story (U. S.), 411.

So, where a railroad company, having declared a dividend upon its stock, *deposited* a sufficient sum *with bankers*, expressly to pay such dividend, but, before the whole amount so deposited was paid out, withdrew the remainder, and subsequently became insolvent, and a receiver was appointed, — it was held that the fund so deposited should be regarded as specially appropriated for the payment of the dividend, and that the stockholders acquired in equity a *lien* upon such fund, to the extent of the amount to which they were respectively entitled, and that the lien followed the fund into the hands of the *receiver*.[1] So, where a dividend, based upon profits actually received, had been declared, payable without interest at such time as might be directed by the board, it was held that the directors had no power, as against dissenting stockholders, thereafter to pass a vote that the amount of the dividend standing credited to each stockholder should be taken from his account and credited to an account known as the surplus fund,— and that they especially had no such power as against one who had sold his shares and reserved the declared dividend.[2]

§ **2132. Banker's Lien on Cash Dividends for Unpaid Balance.** — A banking corporation has a lien upon any cash dividends declared and remaining unpaid in its hands, for the purpose of securing the payment of any debt then due by the stockholder to it. The theory of the law is that dividends in the hands of the bank remain pledged for the payment of any just debt due to the bank from the stockholder.[3] This has been held in regard to a *national bank*,[4] and the reason which upholds such a lien was thus stated by Virgin, J.: "It cannot affect the free sale and transfer of shares; for the dividend does not pass with the transfer of the shares, being the property of him who is the shareholder when it is declared. So long, then, as the plaintiff's overdue notes remain unpaid, he could not recover the dividends declared upon his shares, because of this equitable lien." [5]

[1] Matter of Le Blanc, 4 Abb. N. Cas. (N. Y.) 221.

[2] Beers *v.* Bridgeport Spring Co., 42 Conn. 17.

[3] Bates *v.* New York Ins. Co., 3 Johns. Cas. (N. Y.) 238; Sargent *v.* Franklin Ins. Co., 8 Pick. (Mass.) 90; Hager *v.* Union Nat. Bank, 63 Me. 509, 512.

[4] Hager *v.* Union Nat. Bank, *supra.*

[5] *Ibid.*

§ 2133. Right of Set-off for Debts Due by the Shareholder to the Corporation. — As the dividend when declared becomes so much money owing by the corporation to the shareholder, if the shareholder is at the time indebted to the corporation, the latter has, on principle, a right to apply the dividend in liquidation of the debt. In other words, it has the same right of set-off that any other creditor has.[1] But this right of set-off rests upon a mutuality of indebtedness; and hence where the shares have been assigned, although not on the books of the company, prior to the declaration of the dividend, the corporation has no right of set-off as against the assignee, who becomes the equitable owner, provided it has *knowledge* of the assignment prior to the declaration of the dividend.[2] But this right of set-off obviously exists only where a dividend has been declared; and conversely where no dividend has been declared and the stockholder is indebted to the corporation in respect of his shares by a bond and mortgage, he cannot properly refuse to pay his interest because the directors do not declare a dividend; nor will the collection of such interest be restrained until the directors do make a dividend. This conclusion rests upon the principle already stated that the propriety of declaring a dividend rests primarily in the discretion of the directors.[3]

§ 2134. Theory that Unpaid Dividends are Assets for Creditors. — It has been held that unpaid dividends are assets of the corporation available for its creditors in case it becomes insolvent.[4] But this view is manifestly unsound, unless the declaration of the dividend was fraudulent as against creditors. If a dividend is fairly declared out of the profits existing when it is declared, a *debt* [5] of the corporation is thereby created in favor of each stockholder, and if he does not collect this debt, and the corporation subsequently becomes insolvent, the least that can be said in his favor is that he is in respect of it a *general creditor*, and has the right to have it paid *pro rata* out of the corporate funds on an equal footing with other general creditors. The

[1] Ex parte Winsor, 3 Story, (U. S.), 411, 421, where this principle is recognized by Mr. Justice Story.

[2] Gemmell *v.* Davis, 75 Md. 546; *s. c.* 32 Am. St. Rep. 412; 23 Atl. Rep. 1032.

[3] Ely *v.* Sprague, 1 Clarke Ch. (N. Y.) 351.

[4] Curry *v.* Woodward, 44 Ala. 305. Compare Ex parte Winsor, 3 Story (U. S.), 411.

[5] *Ante*, §§ 2126, 2127.

theory that other general creditors can seize upon his property to pay their debts, ignores the legal distinction between a corporation and its stockholders, and is tantamount to holding that one man may take another man's property without compensation. Besides, such a conception puts the stockholders on an inequality. Those who collect their dividends immediately get them in full, but those who allow them to lie in the treasury of the company are not only not remitted to the rights of general creditors in the event of its subsequent insolvency, but their dividends are confiscated for the benefit of other creditors.

§ 2135. **Reclamation of Dividends Improperly Declared.**— The foregoing holdings assume that the dividend in each case was declared under circumstances in which it *could properly* be declared,—that is to say, where there were profits to divide, and where its declaration was hence within the power and discretion of the directors. It is assumed that there can be no question of the power of the corporation to recall an *ultra vires* dividend. Until the dividend is paid, there is a *locus pœnitentiæ;* neither the corporation nor its directors who have committed the fault, are obliged to go on and consummate an illegal act which is merely *in fieri.* But where the dividend is one which might *lawfully* have been declared, but the directors have acted *improvidently*, or have abused their discretion in declaring it,— then the question whether they or the corporation can recall their action and reclaim the dividend, either before or after it has been actually paid, is a disputable one. It was ruled in the Court of Appeals of Kentucky that if dividends were made under a misconception, on the part of the directors, of what constituted profits, and under the belief that there were profits to divide, when in fact there were none, they might be *reclaimed by the corporation* after they had been paid out. The court regarded it as a case where money has been paid and received under a mutual mistake.[1] This extremely doubtful holding has been quoted with approval by the Kansas City Court of Appeals,[2] though the case before that court required it to go no further than to hold that where a corporation has declared a dividend at a time when is has no surplus or profits to divide, and afterwards becomes

[1] Lexington &c. Insurance Co. *v.* Page, 17 B. Mon. (Ky.) 412; *s. c.* 66 Am. Dec. 165.

[2] Slayden *v.* Seip, 25 Mo. App. 439, 446.

insolvent, — the dividend is not collectible in an action at law.[1]

§ 2136. Reclamation where the Capital Stock has been Divided and the Company has Become Insolvent. — Where dividends have been made and paid out of the capital stock, and the company has subsequently become insolvent, the right to reclaim the dividends from the stockholders is clear. The capital stock being a trust fund primarily for creditors and secondarily for the stockholders, the stockholders cannot pay themselves out of it first; and if they do, the creditors or their representative may maintain a suit in equity to reclaim the dividend so paid. This right of reclamation, it has been held, passes to the *assignee* of the corporation if the terms of the assignment are sufficiently comprehensive to embrace it.[2] In a bill for such reclamation, where the dividends have been declared and paid out of the capital in violation of a statute, it had been held not necessary to aver that any of the present debts existed when the dividend was declared, or that there are not enough assets now to pay the debts.[3] It is immaterial whether the complaining creditors were *prior* or *subsequent creditors*. The assets of the corporation, thus improperly diverted into the hands of its stockholders, remain a *trust fund* out of which they are entitled to have their debts satisfied, and the shareholders who thus receive it are technically guilty of a conversion of it.[4]

§ 2137. Construction of the Iowa Statute Authorizing such Reclamation. — In the Iowa statute providing that if any person is injured by "the diversion of the funds of the corporation to other objects than those mentioned in their articles," * * * and the payment of dividends will not leave sufficient funds to meet the liabilities of the corporation, "such dividends or their equivalent, in the hands of the

[1] *Ibid.* The fact was that the corporation, when financially embarrassed, declared a dividend based upon accounts charged to profit and loss, and largely uncollectible. It was held that, as the dividend was improperly declared, the corporation could not be compelled to pay it. *Ibid.*

[2] Lexington &c. Ins. Co. *v.* Page, 17 B. Mon. (Ky.) 412; *s. c.* 66 Am. Dec. 165; Main *v.* Mills, 6 Biss. (U. S.) 98.

[3] Williams *v.* Boice, 38 N. J. Eq. 364.

[4] McKusick *v.* Seymour &c. Co., 48 Minn. 172; *s. c.* 50 N. W. Rep. 116.

individual stockholders, shall be subject to such liabilties,"[1] — the word "funds" means all the resources of the corporation, and not merely cash on hand; and dividends may lawfully be declared, although enough cash on hand is not left to pay all the corporate liabilities. The word "liabilities" means existing indebtedness at the time the dividend is declared, the payment of which can be enforced; and the capital stock, although in one sense a liability of the corporation, is not a debt within the meaning of the staute.[2]

§ 2138. **Cannot be Forfeited by the Corporation.** — Dividends, after they have been lawfully declared, being, then, the property of the several shareholders, at least in the sense in which a *debt* is property, it follows that they cannot be forfeited or confiscated at the mere pleasure of the company. When, therefore, in reorganizing a corporation whose franchises were about to expire, under a scheme by which the new corporation succeeded to its franchises and obligations, a provision inserted in the charter of the new company, forfeiting dividends not claimed within three years from the time when declared, was not binding upon the old stockholders, except from the time when, expressly or by implication, they consented thereto by assuming the quality of stockholders in the new company.[3]

§ 2139. **Nor Appropriated by the State.**— For the same reason, an unclaimed dividend in a corporation cannot be appropriated by the State without compensation, though possibly circumstances might be imagined where it could be *expropriated* for public use upon payment of just compensation. Thus, a statute of North Carolina provided: "That all dividends heretofore declared or which shall hereafter be declared by any corporation, company or association, whether chartered or not, which shall not be recovered or claimed by suit, by the parties entitled thereto, for five years, after the same were or shall be declared," shall be paid by the corporation, etc., to the trustees of the University of North Carolina; and authorized such trustees to sue for and collect such dividends and to hold them without

[1] Iowa Code, 1873, § 1072; McLain's Code 1888, § 1622.

[2] Miller *v.* Bradish, 69 Iowa, 278; *s. c.* 28 N. W. Rep. 594.

[3] Armant *v.* New Orleans &c. R. Co., 41 La. An. 1020; *s. c.* 7 So. Rep. 35.

liability for profit or interest; and provided that, if no claim should be preferred within ten years, the trustees should hold them absolutely. It was held, on the most obvious grounds, that this statute was unconstitutional, since it was an assertion of power in the legislature to take the property of one man and give it to another without compensation.[1] But it has been held competent for the legislature to enact that an administrator should, after a reasonable time, pay an unclaimed surplus of the estate, either to the State university or other person charged by law with the keeping of the same, for the benefit of the creditors and next of kin; but this was not giving the assets to the university, but merely changing the fund from one agency of the State to another, without changing the trust.[2]

§ 2140. No Discrimination among Shareholders in Respect of Dividends. — Directors of a corporation have no power to discriminate among its shareholders in respect of dividends, unless such power is conferred by the charter or governing statute.[3] This statement has, of course, no reference to dividends on *preferred shares*.[4]

§ 2141. But the Stockholder Discriminated against can not Recoup against Others.—But if the corporation does discriminate against a particular stockholder in the declaration and payment of a dividend, he can not maintain an action against those who have been preferred before him to recover his proportionate share of what they have received. The principle is that a stockholder, whose right to participate in a dividend declared by a corporation has been wrongfully denied by it, cannot maintain an action in the first instance for money had and received against

[1] University *v.* North Carolina R. Co., 76 N. C., 103; *s. c.* 22 Am. Rep. 671. In Wilkinson *v.* Leland, 2 Pet. (U. S.) 657, it is said: "We know of no case in which a legislative act to transfer the property of A. to B. without his consent, has ever been held a constitutional exercise of the legislative power in any State in the Union. On the contrary, it has been constantly resisted as inconsistent with just principles, by every judicial tribunal in which it has been attempted to be enforced." See also Terrett *v.* Taylor, 9 Cranch. (U. S.) 43.

[2] University *v.* Maultsby, 8 Ired. Eq. (N. C.) 257.

[3] Jones *v.* Terre Haute &c. R. Co., 57 N. Y. 196.

[4] *Post*, § 2262, *et seq.*

another stockholder who has participated in such dividend. A stockholder cannot follow the assets of the company into the hands of other stockholders who have received them in the form of dividends, until he has at least established his right as a creditor of the company and exhausted his legal remedies against it.[1] It was also said that if the plaintiff had been an admitted stockholder, and a dividend had been declared upon her shares with the others, and the amount of the dividend had been placed in the hands of a third person for distribution, the case would be within some of the authorities cited by counsel for the plaintiff, in which it was held that a trust was created in favor of the stockholder to whom the dividends were due, and that she could follow the funds into the hands of the party who had thus received it, or his transferee.[2]

§ 2142. Discretion of Directors as to Time and Place of Payment. — In the exercise of their discretion in respect of the declaring of dividends, the directors may, it has been held, fix the time and place of payment within such limitations as reason and good faith to the stockholders may require. They may make them payable at a *banking house* in good credit, giving proper notice to the stockholders of the deposit made there to their credit.[3]

§ 2143. Payable at a Bank which Fails — Who Bears Loss. — If the stockholder, after receipt of notice, neglects to draw the money within a reasonable time, and the bank fails, the loss will fall on the stockholder, and not on the company. But of course the company must show that due notice was given to the stockholder.[4]

§ 2144. When Considered Divided and Paid. — Within a statute relating to taxation[5] dividends are to be considered as divided

[1] Peckham *v.* Van Waggener, 83 N. Y. 40; *s. c.* 38 Am. Rep. 392; aff'g *s. c.* 13 Jones & Sp. 328. Compare Butterworth *v.* Gould, 41 N. Y. 450; Patrick *v.* Metcalf, 37 N. Y. 332.

[2] Citing LeRoy *v.* Globe Ins. Co., 2 Edw. Ch. (N. Y.) 657; Re LeBlanc, 75 N. Y. 598.

[3] King *v.* Paterson &c. R. Co., 29 N. J. L. 82.

[4] King *v.* Paterson &c. R. Co., 29 N. J. L. 82.

[5] Ala. Act 1868, pp. 303, 304, § 12.

and paid over to the stockholders of an insurance company, when the stockholders have received the same in money, or in credits on stock notes in possession of the company.[1]

§ **2145. Dividends in Liquidation.**— These rest on a different footing from dividends of profits made to stockholders while the company is a going concern. They are not, of course, discretionary with the directors who are usually displaced by an assignee, receiver, or other representative of the corporation; and they are declared to be in accordance with the principles of administration in equity, or under rules specially enacted by statute, which in general are the same as those in equity. Those are: 1. That valid lien creditors are first to be paid according to their respective priorities. 2. That general creditors are next to be paid *pro rata*. 3. That what is left,[2] if anything, shall be divided among the shareholders in such a manner as to produce, as far as possible, equality among them.[3] This, of course, means a *pro rata* division among all shareholders standing on an equal footing. Thus, if some of the shareholders have paid for their shares in full, while others have paid in part only, those who have paid in full are entitled to a return of the excess paid by them above that paid by the others, before any division of the balance takes place. This balance is then to be divided ratably among the shareholders; and this has been held to be the proper mode of distribution, although the corporation has been in operation for many years, making dividends of profits in proportion to the amounts paid in by the respective shareholders.[4] It has been held that where an order directing a receiver to pay a certain dividend is neither objected to nor appealed from until after the entry of the final decree in the cause, and after the dividend has been thereupon paid, and its payment confirmed by the court, the validity of the order cannot be questioned on appeal from the final decree.[5]

[1] Citizens &c. Ins. Co. *v.* Lott, 45 Ala. 185.

[2] Stockholders are not entitled to any division of the profits and moneys of a corporation until its debts are paid. Ryan *v.* Leavenworth &c. R. Co., 21 Kan. 365.

[3] *Post*, Ch. 88.

[4] Krebs *v.* Carlisle Bank, 2 Wall. Jr. (U. S.) 33.

[5] Republic Life Ins. Co. *v.* Swigert. 135 Ill. 150; *s. c.* 25 N. E. Rep. 680.

§ 2146. Equalizing Stockholders in Respect of such Dividends.— In an important early case in Maryland, provision had been made, by an act of the legislature,[1] for closing the concerns of the C. Bank, and resolutions were adopted by the directors soon after, authorizing the debtors of the bank to pay their debts in its stock, at a certain rate per share; and that whenever the situation of the bank should authorize it, dividends should be made among the other stockholders, at the same rate, with a condition that, should the stock prove to be worth more or less than the fixed sum, the difference should be paid to or refunded, by the stockholders paying their debts in their stock, who gave bonds so to refund. Certain stockholders, soon after these resolutions, paid off their debts in stock, and subsequently the directors, from time to time, made dividends among the other stockholders, amounting in all to the fixed rate per share; and, upon a bill filed by stockholders who had not paid debts in stock, claiming to be placed on an equality with the others, by an allowance of interest, from the surplus funds of the bank, as they had received their dividends at long intervals, and some time after such credit was given, — it was held that those stockholders who had paid debts to the bank in stock, were to be regarded, in reference to any subsequent distribution of the bank's funds among its stockholders, as if they had received interest on their stock from the time it was credited to them in discharge of their liabilities, since the accumulation of interest on their debts was prevented, and that they should receive no dividends until the others had been placed on an equality with them, as respected interest by dividends from the funds to be distributed.[2]

§ 2147. Where the Stockholders Work as Partners and Draw Out Annual Amounts. — It sometimes happens, especially with mere trading corporations, that the stockholders adopt the corporate form of organization for particular reasons, and then work together as partners in what is called a "close corporation." Where they do this, and, instead of declaring and paying regular dividends, the stockholder draws out for his private purposes annual amounts, his indebtedness for an excess so drawn may be made, in favor of his co-corporators, a *lien on his shares*, according to a view recently taken. The stockholders of a corporation were allowed an annual credit, at a fixed rate per cent., on the agreed value of their stock, and were permitted also, in a recognized course of business, to draw against their shares of the profits. The board of directors declared no dividends, and such profits as were not

[1] Md. Act. of 1819, Ch. 142.

[2] Conscoceague Bank *v.* Ragan, 7 Gill & J. (Md.) 341.

drawn out remained in the business, and were used in extending it. It was held that a stockholder who drew out in excess of the annual credit allowed on his stock was properly chargeable with the amount so drawn. An indebtedness so created became a lien on the stock of a person by virtue of a by-law, to which he assented, that if any indebtedness of a stockholder to the corporation was not paid by a given time, his stock might be applied to its payment, and the statute did not run against such lien when the debt was not paid. A resolution of the board of directors of such corporation that "the report of the assessor of income tax of the profits of last year be made in the individual names of the stockholders and their respective amounts charged to their account when paid," did not constitute a division of the profits.[1]

§ 2148. Taxation of Dividends. — The declaration of a dividend by a corporation on part of its capital stock, raises the presumption that the same dividend is declared on all, and is a sufficient basis for a settlement against the corporation of a tax, as though the same dividend had been declared on all.[2]

Article II. Validity and Propriety of Dividends.[3]

§ 2152. When Ultra Vires and not Permissible. — In the first place, dividends can only be declared and paid *out of profits*

[1] Reading Fire Tr. &c. Co. *v.* Reading Iron Works, 137 Pa. St. 282; *s. c.* 21 Atl. Rep. 170.

[2] Atlantic &c. Tel. Co. *v.* Commonwealth, 3 Brews. (Pa.) 366.

[3] Note. — This subject, so far as it affects the personal liability of directors, is considered in a future title: *post*, Ch. 83, Art. IX.

and *cannot properly be declared and paid out of capital*, with the exception of dividends in liquidation, of which we have already spoken.[1] The reason, briefly stated, is that, the capital stock of the corporation being a trust fund for its creditors, the law does not tolerate that the shareholders should divide it among themselves and leave the creditors in the lurch.[2] Moreover, each stockholder is entitled to have the capital preserved unimpaired for the purpose of carrying on the business for which the company was formed.[3] In this line of thought, it has been held that a savings bank, organized under a statute which authorizes it to pay dividends from "surplus profits," may not declare and pay dividends based on *accrued interest* not actually collected, however certain it is that such interest will be paid.[4] There is hardly any room to doubt that, in the absence of restraint in the governing statutes or by-laws, it is competent to declare and pay a dividend in any property at a fair valuation that the corporation may have on hand, — at least in such property as it might lawfully take in payment of its shares;[5] and if it is a sound view that the directors of a banking company cannot declare a dividend payable in depreciated bank notes,[6] the reason certainly does not arise to the surface, provided all shareholders are treated alike in the matter. Nor is the soundness of the holding of the New York Court of Appeals that a bank dividend declared "payable in New York State Currency" is payable in money, and an offer of payment in uncurrent bills of a bank solvent when such dividend was payable, will not exonerate the banking company,[7] at all apparent, provided that all the stockholders get paid in the currency in which the dividend is declared.[7] But we can readily agree with the Supreme Judicial Court of Maine that a dividend declared at a corporate meeting held outside the State is valid if ratified at a subsequent meeting within the State; but that, if the shares of the shareholder have been forfeited for an assessment laid at such meeting outside the State, he cannot collect the

[1] *Ante*, § 2145.

[2] *Ante*, §§ 1536, 1576.

[3] Slayden *v.* Seip Coal Co., 25 Mo. App. 439.

[4] People *v.* San Francisco Savings Union, 72 Cal. 199.

[5] *Ante*, § 1604, *et seq.*

[6] Ehle *v.* Chittenango Bank, 24 N. Y. 548.

[7] *Ibid.*

[8] *Ibid.*

dividend. He must take as a whole what took place at the meeting, validated as it was by subsequent ratification; he cannot refuse to pay his assessment, retain his shares and get his dividend.[1] Payment of *interest* to shareholders on their shares is *ultra vires* unless specially authorized by charter or statute; [2] and it has been held that payment to stockholders, out of the capital of a corporation having no profits, of *interest* on the amounts paid in on their shares, is *ultra vires*, notwithstanding a provision of the charter that interest shall be paid until otherwise determined by the directors, but that no dividend or bonus shall be payable except out of the profits.[3]

§ **2153. When Not Ultra Vires and Hence Permissible.**— But this principle does not extend so far as to maintain the capital at its original value, where, from its very nature, it is *subject to a steady waste* and depreciation. Accordingly, it has been held by the English Court of Appeal that the company's acts of that country do not prohibit a company formed to work a wasting property, such as a mine or a patent, from distributing as a dividend the excess of the proceeds of such working over the expenses of the working; nor is any obligation imposed on such a company to set apart a *sinking fund* to meet the depreciation in the value of the property; so that a division of the profits without providing such a sinking fund is not a payment of dividends out of capital such as is forbidden by the law.[4] In other words, a limited company formed under this statute, the shares of which have been allotted as fully paid up shares in consideration of assets conveyed to the company under a duly registered contract, is not under obligation to keep the value of its assets equal to the nominal amount of its capital; and the payment of a dividend is not to be considered as a payment out of the capital, merely because no provision has been made for keeping the assets up to the nominal capital.[5] It is further held that, in considering whether a dividend declared by a company whose property is of a wasting character, and has become depreci-

[1] Freeman *v.* Machias &c. Co., 38 Me. 343.

[2] *Post*, § 2236.

[3] Re Sharpe (1892), 1 Ch. 154.

[4] Lee *v.* Neuchatel Asphalte Co., 41 Ch. Div. 1; *s. c.* 6 Rail. & Corp. L J. 266.

[5] *Ibid.*

ated by lapse of time and by mining operations, is to be treated as an honest division of profit, or as a division of the capital under the guise of declaring a dividend, regard will be had to the directions of the articles of association; and if the provision in such articles for a dividend authorizes a mere division of profits and not of "capital" or permanent assets, such provision is not *ultra vires*.[1] The court also hold that where a company's articles of association provide for the declaration of a dividend, without making any reserve for the renewal or replacing of any lease or the company's interest in any property, a dividend so declared is not *ultra vires* as against an ordinary shareholder, on the ground that a considerable portion of the capital and assets have been lost, when, notwithstanding such loss, the present property and assets of the company are larger than when it was first formed.[2]

§ 2154. When Declaration of Dividends Not Obligatory.— Under ordinary circumstances, where a *railroad company* has earned a dividend, and they desire at the same time to retain the moneys so earned, for the purposes of the company, either in making improvements on the road, or for the payment of the company's debts, for the company to retain such moneys, and to issue to the stockholders a corresponding amount of stock, is not in violation of the law.[3] Where the charter of a merchants' exchange company authorized the corporation to *divide* the profits of the exchange among its stockholders at such times as might be deemed expedient, it was held that this did not compel a division of the profits, nor prevent their accumulation; and that such accumulation might legally be invested in the exchange itself so as to be incapable of distribution as a dividend.[4]

§ 2155. Liability of Directors for Improperly Declaring Dividends.[5]— The English courts, which, as already seen, do not recognize as a doctrine of equity the American rule that the

[1] *Ibid.*

[2] *Ibid.*

[3] Howell *v.* Chicago &c. R. Co., 51 Barb. (N. Y.) 378.

[4] Barry *v.* Merchants' Exchange Co., 1 Sandf. Ch. (N. Y.) 280.

[5] See further, under constitutional provisions and statutes, *post*, § 4288, *et seq.*

capital stock of a corporation is a trust fund for its creditors, have in two cases, held the directors of companies personally responsible to the creditors for *improperly declaring dividends.* But one case was an insurance company, in whose deed of settlement a trust in favor of its policy-holders was distinctly declared, which declaration was repeated in its policies.[1] These declarations were, it is supposed, sufficient to create a privity of contract between them and the shareholders, or, at least, to raise a duty on their part in favor of the holder, for the violation of which they would be entitled to maintain an action. The second was governed by § 165 of the company's act, 1862,[2] though Sir George Jessel was of opinion that the liability existed independently of the statute, under the terms of the company's articles of association, which provided that no dividend should be declared except out of profits arising from the business of the company. This was equivalent to holding that the company might, by the articles which they adopted for their internal government, raise a trust in favor of the company's creditors, which the holders might enforce against the company's directors. The articles nowhere declared in terms that the creditors should have the right to hold the directors to account; but, nevertheless, the Master of the Rolls said: "The creditors have the right, as I read the articles, considering the nature of the company, to have the capital kept for the payment of their claims. I think it quite immaterial that the writ is not expressed in the same terms as was done in *Evans* v. *Coventry*. That is the substance of the writ. The limited company trades upon the reputation of being a limited company with a paid up capital to meet its liabilities. It is wholly inconsistent with that representation that the company, having its capital paid up, should pay it back to its shareholders who give the company nothing at all."[3] We have elsewhere seen that a purchase by the directors of shares of the stock of the company with funds of the company, when there is no authority for it in the constitution of the company, is deemed a breach of trust towards the company on the part of

[1] Evans *v.* Coventry, 25 L. J. Ch. 489; on appeal, 8 De Gex. M. & G. 835.

[2] See the statute, Lind. Comp. L., 5th ed., p. 972.

[3] Re National Funds Assurance Co., 10 Ch. Div. 118. Compare Hallett *v.* Dowdall, 21 L. J. (Q. B.) 98; Stringer's Case, L. R. 4 Ch. 475.

the directors who order it.[1] In the case just mentioned, it was ruled in substance that such a purchase was a breach of trust toward the company's creditors.[2] It is quite obvious that a shareholder has no right of action against the directors on the theory of a breach of trust on their part for losses which he may have sustained through dividends improperly declared and paid. "It is obvious," said the court in so holding, "that he could not, directly or indirectly, be allowed again to recover money already once paid him in the shape of dividends."[3]

§ 2156. **When Acceptance of Dividend not a Ratification of Illegal Act of Directors.** — It has been held that the acceptance by a stockholder of a dividend declared upon his stock is not a ratification of the illegal conduct of the directors in *holding a meeting outside the limits of the State*, in direct violation of a statute, at which they vote to appropriate to themselves certain stock.[4] Indeed, it is doubtful if such an act could be ratified at all. But where the legality of the adoption of a resolution, at an annual meeting of the stockholders, to pay interest on their stock was called in question, it was held that the act, if illegal, could be cured by a subsequent ratification, and that such a ratification might be inferred from the act of the corporation in paying the interest of the stockholders in pursuance of the resolution, and from the subsequent passing of a vote to issue certificates for the payment of such interest, and the action of the treasurer in issuing the same.[5]

§ 2157. **Rule for Ascertaining what are Profits to be Divided.**— The following rule for ascertaining what are profits of a railroad company was given by Lord Romilly, M. R.: "All the debts of the company are first payable other than those which, for want of a better expression, may be called funded debts; for instance, if the defendants have raised money by mortgage, under the powers contained in their act, for the purpose of completing their line, this does not constitute such a

[1] *Ante*, § 1548.

[2] *Ibid.* See also the decree in 8 DeGex. M. & G. 846.

[3] Wallace *v.* Lincoln Savings Bank, 89 Tenn. 630; *s. c.* 24 Am. St. Rep. 625.

[4] Hilles *v.* Parrish, 14 N. J. Eq. 380.

[5] Richardson *v.* Vermont &c. R. Co., 44 Vt. 613.

debt as can be paid out of the profits before the profits are divided. But on the other hand, any debts which have been incurred, and which are due from the directors of the company, either for steam engines, for rails, for completing stations, or the like, which ought to have been and would have been paid at the time, had the defendants possessed the necessary funds for that purpose,—these are so many deductions from the profits, which, in my opinion, are not ascertained till the whole of them are paid." [1] This subject is treated of in a future title, with reference to the liability of directors under statutes forbidding the declaration of dividends which impair the capital stock.[2] One of these statutes is so careful as to lay down a rule for the ascertainment of profits which may lawfully be divided, as follows: "In order to ascertain the surplus profits, from which alone a dividend can be made, there shall be charged in the account of profit and loss, and deducted from the actual profits: 1. All the expenses paid or incurred, both ordinary and extraordinary, attending the management of the affairs and the transaction of the business of the corporation. 2. Interest paid or then due, on debts owing by the corporation. 3. All losses sustained by the corporation; and in the computation of such losses, all debts owing to the corporation shall be included, which shall have remained due, without prosecution, and no interest having been paid thereon for more than one year, or on which judgment shall have been recovered that shall have remained for more than two years unsettled, and on which no interest shall have been paid during that period.[3]

§ **2158. An Illustrative English Case.**—In a case decided in the English Court of Appeal, it appeared that the articles of association of a canal company, formed under the Companies Acts, authorized the company, by resolution, to increase its capital, but with the proviso that, save as specified in any such resolution, all new capital should be

[1] Corry *v.* Londonderry &c. R. Co., 29 Beav. 272. For a definition of *net earnings* in the sense of *surplus profits*, see Union Pacific R. Co. *v.* United States, 99 U. S. 420, also note in 99 Am. Dec. 762.

[2] *Post*, §4288, *et seq.*

[3] Ohio Act of Apr. 11th, 1888; Laws Oh. 1888, p. 182. An interesting discussion of the question what may be divided by directors as profits, without incurring a personal liability under such a statute, may be found in Excelsior Water &c. Co. *v.* Pierce 90 Cal. 131; *s. c.* 27 Pac. Rep. 44.

subject to the same provisions as the original capital. The articles also provided that the directors might, in priority to any dividend, set aside out of "profits" any sum as a "reserve fund," for certain specified purposes, or "for any other contingencies or purposes of the company," and might invest the same; that any interest derived from such investment should be dealt with as profits; and that, subject thereto, "the entire net profits of each year" should belong to the stockholders. Subsequently the company increased its capital by the issue of new shares carrying a preferential dividend. Year after year a part of the profits of the business of the company was carried to three reserve funds, to meet (1) the depreciation of the company's steamers, (2) insurance, and (3) canal improvements; and the remaining profits, after providing for the preferential dividend, were distributed among the ordinary stockholders. These reserve funds were not represented by any separate or special investment, but were merely book-keeping entries represented in the company's balance-sheets by property of various kinds. The company's undertaking was eventually sold under a special act of parliament, at a price which left a surplus in excess of the liabilities of the company and the capital paid up on the ordinary and preferential shares. The sale was completed during the currency of a financial year. On the completion of the sale, the company passed resolutions for a voluntary winding up. It had never been found necessary to resort to any of the reserve funds while the company was a going concern, and part of them had been in fact divided among the ordinary shareholders in the form of a *bonus;* and at the date of the sale three funds, representing these reserve funds, were still standing in the company's books. It was held (varying the order of North, J.)[1] that all three reserve funds represented undrawn "profits" uncapitalized, and should therefore be treated as income, to which, subject to the preferential dividends for the broken financial year, the oridinary shareholders were exclusively entitled, and not as "capital" or "assets," distributable among both the ordinary and the preferential shareholders; also, that in taking the accounts for the broken financial year, the value of the plant and book debts should be taken at the actual ascertained values, as stated in the stock books, and not at the lower values at which the company had, according to their regular custom and from motives of prudence, estimated them in a previous annual balance-sheet, on which a dividend had been declared; and that the differences between the two values represented undrawn profits, to which, subject to preferential dividends, the ordinary shareholders were

[1] The decision of North, J., is reported under the name of Re Bridgewater Nav. Co. (1891), 1 Ch. 155.

exclusively entitled. The question as to the circumstances under which undrawn profits can be treated as capital was discussed by the Lords Justices Lindley and Kay. The former of these judges, who, in consequence of his work on this subject,[1] must be regarded as an authority on such questions, in considering whether these undrawn profits had been capitalized or so dealt with that they had become the property of both classes of shareholders, instead of the property of the ordinary shareholders only, said: "Carrying undrawn profits to a suspense account, or to a reserve account, does not necessarily change their character, still less their ownership; they remain the undrawn profits of those persons to whom they belonged, dedicated, no doubt, to certain purposes and applicable to those purposes, but not otherwise altered in their character or ownership. If the purposes for which such property is set apart fail, or if the profits are not required for such purposes, they become divisible, not as capital, but as undrawn profits. When capital and profits belong to the same persons and in the same proportions, it becomes unimportant to distinguish the one from the other, and capitalization may be inferred from slight evidence. But when capital and profits belong to different persons, or to the same persons in different proportions, the effect of capitalizing profits is to change their ownership, and the intention to do this must be shown before the conversion of profits into capital can be properly inferred. Moreover, this is a matter on which a majority cannot bind a minority unless expressly empowered to do so by the constitution of the company, either as originally framed or as subsequently modified by some authority binding on all."[2] And he quoted the dictum of Lord Bramwell in the leading English case in the House of Lords, — "that a trader, whether sole or corporate, trades with all the money he has got, let him have got it how he may. A sole trader, with a capital of 10,000 pounds, who makes in a year a profit of 2,000 pounds, and spends 1,000 pounds only, leaving the other 1,000 pounds in his business, may well in the next year be said to have a capital of 11,000 pounds; not so where there is a partnership, whether an ordinary partnership or an incorporated partnership. They are the undivided profits of any period, a year, or shorter or longer time, and continue to be undivided profits, unless something in the articles of partnership or some agreement by all the partners makes them capital. They do not become capital by effluxion of time or by their being used in trade."[3]

[1] Referring to Lindley's Company Law.

[2] Re Bridgewater Nav. Co. (1891), 2 Ch. 327.

[3] Bouch v. Sproule, 12 App. Cas. at p. 405.

§ 2159. Dividing Sum Derived from Sale of Part of Undertaking. — According to a recent English holding, a sum derived from a sale of a part of the undertaking of a banking company, remaining after deducting from the proceeds of the sale a part as capital and incidental expenses, is *profit* on capital, which may be distributed as dividends.[1]

§ 2160. Dividend by Consolidated Corporation out of Earnings of Precedent Corporation. — A consolidated corporation has no power to declare a dividend, as such, of the earnings made prior to the consolidation by one of the companies, which was merged in the consolidation, or dividends on the stock of that company out of the earnings of the consolidated one, and courts will not compel it to declare such a dividend.[2]

§ 2161. Equalizing Appreciation and Depreciation. — A land company which, for the purpose of equalizing a bad debt, has brought into its profit and loss account in a previous year the appreciation of its lands, is not bound in a subsequent year to bring into such account a depreciation in the lands, so as to prevent the declaration and payment of a dividend from the profit of that year.[3]

§ 2162. Purchase of the Shares of a Member to be Paid Out of Corporate Earnings. — Where the shareholders in a manufacturing corporation consisted of three persons only, and two of them, desiring to become the owners of all the shares of the third, agreed with her to purchase all her shares for a part payment in cash, the remainder to be paid in installments out of the income of the company, which payment out of the income should not limit the personal liability of the purchasers to pay for the shares, — it was held that this was not a purchase of the shares by the company, but was a purchase of them by the two shareholders for themselves, and that so much of the agreement as stipulated for the payment of the deferred installments out of the earnings of the company was merely a mode of anticipating the dividends or profits of the company by the only shareholders who were entitled to receive them.[4]

§ 2163. A Statute of California[5] prohibits payment to the stockholder of any part of the capital stock before dissolution or ex-

[1] Lubbock *v.* Bank of South America (1892), 2 Ch. 198.

[2] Chase *v.* Vanderbilt, 37 N. Y. Super. 344.

[3] Bolton *v.* Natal Land &c. Co. (1892), 2 Ch. 124.

[4] Schilling &c. Brewing Co. *v.* Schneider, 19 S. W. Rep. 67; *s. c.* 110 Mo. 83.

[5] Cal. Civ. Code, § 309.

piration of the term of corporate existence. Under the operation of this statute, a division cannot be made among stockholders prior to dissolution or expiration of the term of the corporate existence, of the stock of a new corporation to which it, in common with a foreign corporation, has transferred its property for the purpose of uniting their conflicting interests, although such division has been unanimously agreed upon by all the stockholders, and has actually been made among the stockholders of the foreign company; since the stock of the new corporation, received in exchange for their property, is included in the term "capital stock."[1]

§ 2164. Status of Shareholders of Unincorporated Joint Stock Companies. — Although they may be partners in respect of strangers, the shareholders in an unincorporated joint-stock association are *not tenants in common* of its property, but their shares are in the nature of personal property, and consist of a right to participate in the profits, either in the form of current dividends while the company is a going concern, or in a division of its capital on its being wound up after the payment of its debts. Such a partnership differs from an ordinary partnership in the further fact that it is not dissolved by the death of a member.[2]

Article III. Stock and Scrip Dividends.

§ 2167. Stock Dividends Lawful.—In the absence of a statute restraining such action, it is within the discretion of the directors of the corporation, or at least within the power of the corporation, to issue additional shares of stock to represent its surplus profits, and to divide such stock *pro rata* among its ex-

[1] Kohl *v.* Lilienthal, 81 Cal. 378; *s. c.* 6 L. R. A. 520; 22 Pac. 689.

[2] Re Oliver's Estate, 136 Pa. 43; *s. c.* 9 L. R. A. 421; 26 W. N. C. 392; 21 Pitts. L. J. (N. S.) 115; 47 Phil. Leg. Int. 535; 20 Atl. Rep. 527. That such in general is the nature of membership in a joint-stock company organized under the laws of New York, *e. g.*, the Adams Express Co., see Spooner *v.* Phillips, 62 Conn. 62; *s. c.* 24 Atl. Rep. 524. To the same effect see Kramer *v.* Arthurs, 7 Pa. St. 165.

isting shareholders.[1] The reason is in substance that the effect of doing this is merely to change the form of ownership of the capital of the corporation. For instance, if the company has accumulated a surplus profit of fifty per cent., and its shares are of the denomination of $100 each, this would ordinarily increase the value of each share to $150. But each shareholder might prefer to hold a greater number of shares at par value. He might, for instance, prefer to have fifteen shares worth $100 each rather than ten shares worth $150 each. If this is all there is in the matter, and if the corporation has the power under its governing statute, to increase its capital stock to the extent thus effected, no inequality is produced among the stockholders, no property is withdrawn from creditors, no one is harmed, and no principle of public policy is violated. It is clear, then, that, under the circumstances named, ordinary trading corporations may rightfully issue stock dividends is respect of their surplus profits. But corporations which derive their revenues from *public tolls*, stand on a very different footing; and it is well known that the practice of "watering their stock" by the declaration of stock dividends on which they struggle to pay annual dividends in cash, has been a fruitful source of oppression to the public.

§ 2168. **What are not Stock Dividends.**—It has been held that a cash dividend, declared out of profits by a corporation, indebted nearly to the amount of such profits for permanent improvements, which is exactly sufficient to pay for the proportion of new stock at par, issued at the same time and allotted to each stockholder, for subscription, and which the stockholders may elect to invest in the new stock, or may retain, selling the right to subscribe for the new stock, which is worth more than par, is not a stock dividend; but is to be treated, as

[1] Williams *v.* Western Union Tel. Co., 93 N. Y. 162; *s. c.* 9 Abb. N. C. 437; reversing *s. c.* 48 N. Y. Super. (16 J. & Sp.) 349; 61 How Pr. 216. See also Howell *v.* Chicago &c. R. Co., 51 Barb. (N. Y.) 378; Jones *v.* Terre Haute &c. R. Co., 57 N. Y. 196; Kenton Furnace &c. Co. *v.* McAlpin, 5 Fed. Rep. 743; Minot *v.* Paine, 99 Mass. 101; *s. c.* 96 Am. Dec. 705; Rand *v.* Hubbell, 115 Mass. 471; Brown *v.* Lehigh Coal &c. Co., 49 Pa. St. 270; Commonwealth *v.* Pittsburgh &c. R. Co., 74 *Id.* 83; Barton's Trust, L. R. 5 Eq. 239; Mills *v.* Northern R. &c. Co., L. R. 5 Ch. 621.

between a life tenant and a remainder-man, as income.[1] Under an act of the legislature of North Carolina, authorizing a bank to retain a certain share of the "dividends" upon the stock owned by the State, towards certain unpaid stock of the State, — it was held that a portion of the capital stock divided among the stockholders was not dividends within the act.[2] Bank shares being the individual property of the stockholders, and not the property of the corporation, unless purchased in payment of debts, it has been reasoned that where new stock is created and *sold at a premium*, such premium is the property of the stockholders, and a dividend of the same among the old stockholders, is not a dividend, within the meaning of a statute taxing dividends of banks.[3] By an act of the legislature of Massachusetts, the treasurer of the State was authorized to assign to a certain railroad company all the shares of capital stock of the company, owned by the State or belonging to funds over which the State had exclusive control, in exchange for bonds of the company; and the company was to "hold and dispose of the shares of stock so assigned to it as its absolute property."[4] It was held that the company might divide such shares among its stockholders, notwithstanding a general statute forbidding a railroad company to declare a stock dividend without authority of the legislature.[5]

§ 2169. Bonds in Lieu of Cash Dividends.—A railroad corporation may issue to its stockholders bonds in lieu of cash dividends to represent earnings which have been used in construction, and four years' dividends may be declared thus, at one time, instead of each year, they having been duly earned.[6]

[1] Davis *v.* Jackson, 152 Mass. 58; *s. c.* 25 N. E. Rep. 21.

[2] Attorney-General *v.* State Bank, 1 Dev. & B. (N. C.) Eq. 545.

[3] State *v.* Franklin Bank, 10 Ohio 91.

[4] Mass. Stat. 1882, c. 121, §. 1.

[5] Com. *v.* Boston &c. R. Co., 142 Mass. 146; *s. c.*, 7 N. E. Rep. 716.

[6] Wood *v.* Lary, 47 Hun (N. Y.), 550.

ARTICLE IV. RIGHT TO DIVIDENDS AS BETWEEN SUCCESSIVE OWNERS OF SHARES.

§ 2172. Dividends Belong to the Owner of the Stock at the Time when the Dividend is Declared. — The general rule, stated in the briefest way, is that a dividend belongs to the one who is the owner of the stock at the time when the dividend is actually declared, irrespective of the time when it is earned, although it may be made payable at a future date.[1] This results from principles already considered, that the stockholders of a corporation have no claims to a dividend until it is declared. Until that time, the dividend belongs to the corporation, precisely as any other property which the corporation may own, and each share

[1] Brundage *v.* Brundage, 65 Barb. (N. Y.) 397; Re Foote, 22 Pick. (Mass.) 299; Clapp *v.* Astor, 2 Edw. Ch. (N. Y.) 379; Phelps *v.* Farmers &c. Bank, 26 Conn. 269; Hyatt *v.* Allen, 56 N. Y. 553; Jones *v.* Terre Haute &c. R. Co., 29 Barb. (N. Y.) 353; *s. c.* 17 How. Pr. (N. Y.) 529; Bright *v.* Lord, 51 Ind. 272; *s. c.* 19 Am. Rep. 732; Hill *v.* Newichawanick Co., 48 How. Pr. (N. Y.) 427; Goodwin *v.* Hardy, 57 Me. 143; March *v.* Eastern R. Co., 43 N. H. 515. Compare Currie *v.* White, 37 How. Pr. (N. Y.) 330, 384; *s. c.* 6 Abb. Pr. (N. s.) (N. Y.) 352. *Contra*, Burroughs *v.* North Carolina R. Co., 67 N. C. 376; *s. c.* 12 Am. Rep. 611.

of stock represents a present interest in it, and that interest passes upon a transfer of the share.[1]

§ 2173. Right to Undivided Profits Passes with the Stock.— The meaning of the preceding rule is that the profits and surplus funds of the corporation, whensoever they may accrue, are, until separated from the capital by the declaration of a dividend, a part of the stock itself, and will pass with the stock under that name in a transfer or bequest.[2] Another way of stating the principle is to say that the purchaser of a share of stock in a corporation takes the share with all its incidents, one of which is the right to receive all future dividends declared on such share.[3] Nor does it make any difference at what times or from what sources the profits thus divided may have accrued; they are an incident to the share, to which the purchaser becomes at once entitled, provided he remain a member of the corporation until a dividend is made.[4] In still other words, a stockholder in a corporation has an interest in proportion to the amount of his stock, in all the corporate property, and has a right to share in any surplus of profits arising from its use and employment in the business of the company; and this right does not depend upon the time when he became a stockholder, but attaches whenever he acquires the stock, and entitles him to all subsequent dividends.[5]

§ 2174. Dividend Declared does not Pass with a Future Transfer of the Stock. — The meaning also is that when a dividend is declared, it is so much money segregated from the capital of the company, and held as the property of each shareholder according to the number of his shares. It is therefore,

[1] Goodwin *v.* Hardy, 57 Me. 143.

[2] Phelps *v.* Farmers and Mechanics' Bank, 26 Conn. 269; Jones *v.* Terre Haute &c. R. Co., 57 N. Y. 196; Ryan *v.* Leavenworth &c. R. Co., 21 Kan. 365; Jermain *v.* Lake Shore &c. R. Co., 91 N. Y. 483; Marble *v.* Van Wert Bank, 3 Ohio Circ. Ct. 464. Compare Burroughs *v.* North Carolina R. Co., 67 N. C. 376; *s. c.* 12 Am. Rep. 611.

[3] March *v.* Eastern R. Co., 43 N. H. 515.

[4] *Ibid.*

[5] Jones *v.* Terre Haute &c. R. Co., 57 N. Y. 196. See also Williams *v.* Western Union Tel. Co., 93 N. Y. 190; Jones *v.* Morrison, 31 Minn. 153; Hyatt *v.* Allen, 56 N. Y. 553; *s. c.* 15 Am. Rep. 449; Clapp *v.* Astor, 2 Edw. Ch. (N. Y.) 379; Re Barton's Trust, L. R. 5 Eq. 238.

as already seen, the individual property of the shareholders, and no part of the common property which is called the capital stock. No right to it therefore passes with the transfer of shares unless the contract expressly so provides.[1] And this is so without reference to the date at which the dividend is made payable, for it is the *declaration* of the dividend that creates the segregation and establishes the debt from the corporation to the stockholder.[2] But in disregard of this principle, it has been held that where, at the time of the sale of shares, a dividend has been declared by the directors, payable on a day subsequent to the sale, the sale, in the absence of a stipulation on the point, carries to the vendee the right to the dividends.[3]

§ 2175. Dividends Declared Previously to the Transfer, but Payable Thereafter. — From the foregoing principles it also results that in the absence of any provision to the contrary in a contract of sale and purchase of stock, made outside of and not subject to the rules of the stock exchange, dividends previously declared but made payable thereafter, belong to the seller and are not transferred by the contract.[4] Speaking of this subject, it was said by Vice-Chancellor Sir W. Page Wood (afterwards Lord Hatherley): "As soon as the dividend was declared, although payment, for the convenience of the company, was postponed until the following January, — from that moment the testatrix became entitled to it, although she could not have then recovered it, and would have passed to her legatee had she specially bequeathed it." [5]

§ 2176. Custom not Admissible to Alter these Principles. A custom of brokers, by which dividends declared but not

[1] Hopper *v.* Sage, 112 N. Y. 530; *s. c.* 21 N. Y. St. Rep. 591; 20 N. East. Rep. 350.

[2] Wheeler *v.* Northwestern Sleigh Co., 39 Fed. Rep. 347.

[3] Burroughs *v.* North Carolina R. Co., 67 N. C. 376; *s. c.* 12 Am. Rep. 611. See also Curry *v.* Woodward, 44 Ala. 305.

[4] Hopper *v.* Sage, 112 N. Y. 530; *s. c.* 20 N. E. Rep. 350; 21 N. Y. St. Rep. 491; 8 Am. St. Rep. 771; Jones *v.* Terre Haute &c. R. Co., 29 Barb. (N. Y.) 353.

[5] DeGendre *v.* Kent, L. R. 4 Eq. 283. Where a contract is made for the sale of stock, on which a dividend has been declared, payable upon a day subsequent to the agreed time of delivery of the stock, such dividend does not pass to the buyer. Spear *v.* Hart, 3 Robt. (N. Y.) 420.

paid, belong to the buyer of shares, is not admissible to alter the legal rights of the parties to such a transaction.[1]

§ 2177. **Rules of Stock Exchanges.** — But where the parties to the transaction are members of a stock exchange, which has adopted rules on the subject different from the rule of the law, these rules may be regarded as entering into any contract made between the members of the body, and as superseding as to them the rule of the law.[2]

§ 2178. **Application of these Principles to "Option" Sales.** — When, therefore, an "option" of stock is sold, that is to say, when the owner of stock makes a contract with another by which he gives him the option of purchasing from him the stock at or before a certain date, and that other elects to accept the shares on the *last day* of the option, he will not get a dividend which has been declared between the date of the contract and the expiration of the option, unless it passes to him by the express terms of the agreement.[3] But where A. agreed with B. to accept from bearer, at any time within thirty days, certain shares of stock at a certain price, A. to be "entitled to all dividends or extra dividends declared during the time," it was held that A. was not entitled to a dividend which had been *previously declared*, but which was *payable* during the thirty days.[4]

§ 2179. **Same Rule as to Interest in Case of Interest-bearing Stock.** — The same rule applies in respect of interest accruing upon shares of stock, in case the stock has annexed to it the peculiar feature that it bears interest. Thus, where a stockholder in a railway company assigned and transferred his stock after two years interest thereon had accrued, which, by a resolution of the company, was payable annually, and which had been carried to the account of the stockholder, — it was held that this interest did not pass by an assignment of the stock

[1] Spear *v.* Hart, 3 Robt. (N. Y.) 420.

[2] See Hopper *v.* Sage, 112 N. Y. 530; *s. c.* 8 Am. St. Rep. 771; 20 N. E. Rep. 350.

[3] Bright *v.* Lord, 51 Ind. 272; *s. c.* 19 Am. Rep. 732.

[4] Hopper *v.* Sage, 112 N. Y. 530; *s. c.* 20 N. E. Rep. 350; 8 Am. St. Rep. 771.

without express words evidencing such an intent. The court state the rule to be that "the interest follows the principal, as an incident to it, so long as it remains an incident; but when it is separated and set apart from the principal by actual payment, or by being carried, when due to the credit of the owner of the principal in his account with the debtor, and this in pursuance of a provision in the contract creating and defining the particular debt, it is so separated and disjoined from the principal as to cease to be an incident to, and does not follow it."[1]

§ 2180. **How in Case of Unrecorded Transfers.** — As elsewhere pointed out, the object of recording, on the books of the corporation, transfers of the shares of its stock is to protect the corporation itself, and, as a general rule, as between the corporation and the shareholder, he is to be deemed the owner who stands on the books of the corporation as the owner.[2] This rule is varied by another rule frequently acted upon by the courts, that where the corporation, through its proper officers, has actual notice, or notice of such facts as, in the exercise of its duty, ought to put it upon inquiry, that another person is the real or beneficial owner, — as where the shares are *held in trust*, or where a transfer has been made which has not yet been registered, the corporation acts in its own wrong if it ignores the rights of such beneficial owner.[3] In the case where shares have been transferred, it is undoubtedly the rule that, although the transfer has not been recorded yet, as between the transferor and transferee, the transferee has the right to dividends declared after the date of the transfer.[4] "If not so registered, and the corporation pays the dividend in good faith, without notice of the transfer to the nominal owner, the payment would be undoubtedly a good one." Such was the opinion advanced *obiter* by a learned judge in a recent case;[5] and such was the opinion thrown out in an earlier case.[6] But this does not seem entirely clear, when it is considered that the bank might easily

[1] City of Ohio *v.* Cleveland &c. R. Co., 6 Oh. St. 489.

[2] *Post,* § 2387.

[3] *Post,* § 2528.

[4] Gemmell *v.* Davis, 75 Md. 546; *s. c.* 32 Am. St. Rep. 412; 23 Atl. Rep. 1032.

[5] McSherry, J., in Gemmell *v.* Davis, *supra.*

[6] Bank of Utica *v.* Smalley, 2 Cow. (N. Y.) 770, 780, per Savage, C. J.

require the shareholder to produce his certificate before receiving his dividend, and that a shareholder might easily comply with the obligation in case he had not transferred his shares.

§ 2181. Right of Pledgee to Dividend Ceases after Extinguishment of Debt. — It seems that the right to dividends is in the pledgee during the period of the pledge and until the payment of the debt for which the pledge was made, unless the contract of pledge otherwise provides. After the debt is satisfied, the pledgee loses all interest in the dividends, and cannot thereafter object that they have been paid to B. instead of to A., the pledgor.[1] This is in conformity with the analogous rule in the law of pledge, that the pledgee may make reasonable *use* of the thing pledged if he does not injure it, but is responsible if he does.[2] The *renewal* of a note secured by a pledge of corporate stock, upon which a new contract of pledge is given and the old contract and note returned, is, where the book entries of the pledge indicate that such was the intention, an *extinguishment* of the original contract of pledge, so far as to deprive the pledgee of dividends accruing before the renewal.[3] The pledgee being entitled to the dividends during the period of the pledge, the corporation becomes liable to him, where it appears from the books of the corporation that he is the owner of the shares, in case the corporation pays dividends to the pledgor; and it has been held that the corporation is not relieved from such liability by the fact that the pledgee received part payment of the debt, surrendered to the pledgor a note evidencing the same and accepted another for the balance, so long as he retained the stock as collateral and had no knowledge that the dividends had been so paid.[4] And although the transfer to the pledgee may not have been made on the books of the corporation, yet it has been held that if the corporation has knowledge of the transfer and

[1] Cross *v.* Eureka &c. Co., 73 Cal. 302; *s. c.* 2 Am. St. Rep. 808; Gemmell *v.* Davis, 75 Md. 546; *s. c.* 32 Am. St. Rep. 412; 23 Atl. Rep. 1032; Hill *v.* Newichawanie Co., 8 Hun. (N. Y.), 459; *s. c.* affirmed, 71 N. Y. 593.

[2] Jones Bailm. 81; Story Bailm., §§ 329, 330; Thompson *v.* Patrick, 4 Watts (Pa.), 414; Lawrence *v.* Maxwell, 53 N. Y. 19.

[3] Fairbank *v.* Merchants National Bank, 132 Ill. 120; *s. c.* 22 N. E. Rep. 524.

[4] Boyd *v.* Conshocken Worsted Mills, 149 Pa. St. 363; *s. c.* 24 Atl. Rep. 287.

subsequently declares a dividend, such dividend belongs to the pledgee, and cannot be retained by the corporation as a set-off against an indebtedness due to the corporation by the pledgor prior to the transfer in pledge.[1] Nor can the corporation in such a case exonerate itself from the liability to pay dividends to the pledgee, by setting up a by-law providing that transfers of stock must be made on the books of the corporation.[2]

§ 2182. **Illustration of these Principles.** — On the 15th of January, 1856, the directors in a corporation voted that dividends be declared on the business of six months, ending on 31st May and 30th of November. The stock and transfer books were closed on 30th of November and opened on 16th of December, and a dividend was declared on the 17th of December, "payable out of the surplus earnings of the road, ending November 30th, payable January 6th." The plaintiff became a stockholder on the 16th of December, a certificate for stock dated 3d December having been mailed to him by the secretary of the company, who had, however, previously informed him that he was not entitled to the dividend. Here, it was held that, as the plaintiff became a stockholder on the 16th of December, and as the dividend was declared on the 17th, he was entitled to it.[3]

§ 2183. **Right to Dividends in Cases Depending on Particular Facts.**— In an early case in Maryland it appeared that B., being indebted to a bank for a loan, and being the owner of 380 shares of its stock, empowered the president to transfer the shares to himself in trust for the bank, to secure payment of the debt and interest. The bank afterwards made a call on each share, to which B. failed to respond. Afterwards the president retransferred the stock, and B. paid the loan with interest. Between the time for paying the installment and the retransfer, the bank declared two dividends, to recover which B. brought assumpsit. It was held that his neglect to pay the installment forfeited his claim to those dividends, and that the action could not be sustained.[4] - - - - In a case in New Hampshire it appeared that on the 6th of March, A. made a written proposal to B. to convey to him all his right and title in certain shares in a turnpike, at $5 per share, provided B. gave security for the price by the 24th of March. After this

[1] Gemmell *v.* Davis, 75 Md. 546; *s. c.* 32 Am. St. Rep. 412; 23 Atl. Rep. 1032.

[2] Central Nebraska Nat. Bank *v.* Wilder, 32 Neb. 454; *s. c.* 49 N. W. Rep. 369.

[3] Jones *v.* Terre Haute &c. R. Co. 29 Barb. (N. Y.), 353.

[4] Marine Bank of Baltimore *v.* Biays, 4 Har. & J. (Md.) 338.

A. received a dividend on the shares, and B., not knowing that the dividend had been received, on the 18th of March gave security for the price, and took a conveyance of all the interest A. then had in the shares. It was held that the dividend received by A. belonged to B., and that B. could recover it in an action for money had and received.[1] - - - - In a recent case in Georgia, the court held that if, after a contract for the sale of certain shares of the stock of a corporation, but before the time appointed for receiving payment and making delivery, a dividend is declared, as to which there is no express stipulation in the contract, — the purchaser, although if he had accepted the stock and paid for it, would have been entitled to the dividend, yet he had no right to decline acceptance because the seller claimed the dividend as his own and refused to give an order for it to him. Having failed without just cause to comply with his contract of purchase, he lost his hold on both the stock and the dividend.[2] - - - - In a case decided in the English Exchequer Chamber, shares of a company were sold at auction on August 1, and a deposit was paid. By the conditions of the sale the purchase was to be completed on August 29, which accordingly was done and the transfers signed. The conditions of sale were silent as to dividends, and in the meanwhile, on August 24, a dividend was declared in respect of a period antecedent to the sale by auction. It was held that such dividend belonged to the purchaser.[3] - - - - Where a corporation which has been paying its secretary a fixed salary and also allowing him to receive the dividends on certain stock as additional compensation, withdraws his right to further dividends, and the secretary, as soon as he learns thereof, leaves the company's service, the fact that, after being notified of the withdrawal, he made no reply, and was paid the balance due him on his fixed salary, and dividends on other stock owned by him, and had other dealings with the company, does not estop him from claiming the dividends accruing up to the time he left the company's service.[4]

§ 2184. Contract to Pay in Shares does not Include Dividends. — A contract to issue stock at the rate of 150 shares per mile of road finished, payment to be made as soon as the superintendent should approve the road as completed, has been held to be fulfilled by an issue of stock to that amount exclusive of dividends.[5]

[1] Harris *v.* Stevens, 7 N. H. 454.

[2] Phinizy *v.* Murray, 83 Ga. 747; *s. c.* 6 L. R. A. 426; 10 S. E. Rep. 358.

[3] Black *v.* Homersham, 4 Exch. Div. 24.

[4] Crane Bros. Man. Co. *v.* Adams, 142 Ill. 125; *s. c.* 30 N. E. Rep. 1030.

[5] Southwestern R. Co. *v.* Papot, 67 Ga. 675.

§ 2185. Contract with Shareholder Respecting Dividends Extends only to Dividends Declared. — Recurring to the principle that a shareholder has no legal title to the corporate property or profits until a division is made,[1] it follows that a contract by him in reference to dividends and profits upon his stock includes only dividends or profits ascertained and declared by the company and allotted to the stockholders, and not profits to be ascertained by third persons or courts of justice, upon an investigation of the accounts and transactions of the company.[2]

§ 2186. Authority of Agent to Sell Shares does not Authorize Sale of Dividends. — It also follows from the foregoing principles that an authorization given to an agent to sell shares does not include an authority, either real or apparent, to dispose of a dividend previously declared.[3]

§ 2187. Right to Stock Dividends as between Successive Shareholders. — As between successive proprietors of the shares, the right to a stock dividend stands on precisely the same footing as the right to a cash dividend;[4] it belongs to those who are the holders of the stock *at the time of the declaration of the dividend*, without regard to the source from which, or the time during which, the funds divided were acquired by the corporation.[5] Thus, where a company purchased some of its own stock, and, after a time, by a corporate vote, divided it among the stockholders *pro rata*, upon the basis of the shares then held by them respectively,—it was held that a stockholder who had sold part of his shares after the stock purchase, but before the dividend, was not entitled to a division upon the basis of the shares held by him at the time of the purchase.[6]

[1] *Ante*, §§ 1071, 2127.

[2] Hyatt *v.* Allen, 56 N. Y. 553.

[3] Wheeler *v.* Northwestern Sleigh Co., 39 Fed. Rep. 347. Where an agent, instead of selling corporate stock, as authorized by his principal, sold previously declared dividends, and turned over the exact amount for which he was authorized to sell the stock, the principal having no knowledge that he had violated his authority, the retention of the money by the latter did not amount to a *ratification*. *Ibid.*

[4] *Ante*, § 2172.

[5] Jermain *v.* Lake Shore &c. R. Co., 91 N. Y. 483.

[6] Coleman *v.* Columbia &c. Co., 51 Pa. St. 74.

§ **2188. What Scrip-Holders Entitled to Dividends where there has been a Succession of Ownership.** — It seems that the holders of scrip certificates convertible into stock, stand on the same footing as the purchaser or assignee of the stock in respect of the right to dividends; they are only entitled to such dividends as accrue on the shares which they acquire by the conversion of their scrip, and which are declared subsequent to such conversion. This may be illustrated by a case in Pennsylvania, where a corporation, restricted to six per cent. dividends out of profits to its stockholders, issued *scrip certificates*, to represent additional profits, entitling the holder to additional shares of stock. The certificates, which were distributed ratably among the shareholders, provided, in pursuance of the resolution authorizing their issue, that the scrip might be *converted into stock*, as soon as the funded debt of the company was paid off, or adequate provision made therefor when due and payment demanded; and, further, that it should not be entitled to any cash dividend until so converted. It was held that the scrip-holders were not entitled after the conversion had been made, to the back dividends declared on the stock from the date of issue to the date of conversion, but only to such as were declared subsequent to the conversion.[1]

Article V. Right to Dividends as Between Life-Tenant and Remainder-Man.

[1] Brown *v.* Lehigh &c. Co., 49 Pa. St. 270.

§ 2192. Right to Stock Dividends as Between Life-Tenant and Remainder-Man; General Considerations. — Where a deed or will vests in a trustee certain property, upon a trust to pay the income thereof to A., and to reserve the capital or *corpus* for B. after the death of A., and a portion or all of this property consists of corporate shares, and the corporation elects to make what are known as "stock dividends," — the question whether these dividends go to the life-tenant or to the remainder-man has given great perplexity to the courts and provoked a contrariety of opinion. The question is so plainly susceptible of fair argument on both sides, and the room for doubt is so obvious, that no draftsman of a will ought to leave the point obscure if he can avoid it. 1. On the one hand, a stock dividend may be regarded as merely a change in the form of ownership of the corporate capital. In this view, and taking a case supposed in a former section for illustration,[1] to give the new share certificates to the life-tenant would seem to rob the remainder-man. 2. On

[1] *Ante*, § 2167.

the other hand, no corporation has the right to divide its capital except in liquidation, and then the creditors stand first and the stockholders next in the distribution.[1] It follows that a dividend, whether of cash or of stock, made by a corporation when a going concern, — in other words, a dividend to its shareholders and not to its creditors, — is presumptively a dividend of its profits or accretions only. As a stock or scrip dividend is, therefore, only a form adopted by the corporation of distributing to its shareholders these profits or accretions, there is room for a cogent argument that a court of justice should go through the form to the substance and declare that such dividends go to the life-tenant under the name of profits or income. 3. But a reply to this, applicable in many cases, will be that the new value represented by the new shares does not consist in *earnings* or in *income* of the corporation — does not represent *money in its treasury* that it determines to hold and use in the increase of its plant or otherwise, instead of dividing it in the form of cash dividends, — but merely represents *natural growth* or *increase in the value* of its permanent property ;— in which case it ought not to be distributed to the life-tenant as income. These considerations show that, instead of attempting to lay down a hard and fast rule on the subject which shall be applicable to all cases,— and herein lies the chief mistake which the courts have made in dealing with it, — it should be determined upon the consideration of the *actual nature of the dividend* in each particular case. The fact that it may be inconvenient to make this determination in many cases is no reason why the courts should recoil from it, since in most cases justice imperatively demands that it should be done. In making this determination, the courts should constantly keep in view the difference between a stock dividend based upon the actual growth and increase in value of the corporate plant and business, and such a dividend based upon the cash earnings or income of the business, which the corporation may have elected to retain and use in the betterment of its property or in the increase of its business facilities.[2]

[1] See the reasoning of Earl, J., justifying the right to declare stock dividends on this ground. Williams *v.* Western Union Tel. Co., 93 N. Y. 162, 174.

[2] The difficulty of discriminating be-

§ 2193. All Dividends Presumptively go to the Life-Tenant. — As the question thus plainly admits of opposing conclusions, and as it is thrown into great confusion by the contrariety of judicial opinion, the author feels justified in attempting to deal with it on principle. We have already seen, the well-known rule is that where there has been a succession of ownership of shares, the right to ordinary dividends is in the person who was the holder of the shares *at the time when the dividend was declared.*[1] We may also assume, on the reasoning of the preceding section, that dividends, whether declared in cash, in scrip, or in new shares, are *presumptively dividends of profits*, since a corporation has no power to make a dividend of its capital stock except in liquidation. We may conclude, therefore, on principle, that presumptively every dividend whether in cash, in scrip, or in new shares, goes to him who was the beneficial holder of the shares at the time when it was declared. This will carry every dividend presumptively to the life-tenant, instead of the remainder-man. It will also cast upon the latter the *burden* of showing a state of facts which changes the operation of the governing principle, — that is, of showing that the particular dividend was, in fact, a dividend of capital, and not a dividend of profits — that is, that it was merely a plan adopted by the corporation of increasing the *number* while diminishing distributively but not in the aggregate, the *value* of its shares, and that the new shares were not issued to represent earnings or income.

§ 2194. Profits Accruing During the Life-Time of the Testator but Divided after his Death. — Under the rule frequently called the *Pennsylvania rule*, this presumption often yields upon an inquiry into the real *substance* of the transaction. That rule is that "when the stock of a corporation is, by the will of a testator, given in trust, the income thereof for the use of the ben-

tween the rights of the life-tenant and the remainder-man is not confined to cases where the *corpus* of the estate consists of corporate shares, but it equally arises in cases where the estate is invested in other property. The principle on which judges have proceeded in modern cases where the estate was invested in property other than corporate shares may be illustrated by Re Foster, 60 L. J. Ch. 175; *s. c.* 45 Ch. Div. 629; and Re Sheldon, 58 L. J. Ch. 25; *s. c.* 39 Ch. Div. 50. See also Porter *v.* Baddeley, 5 Ch. Div. 542.

[1] *Ante*, § 2172.

eficiary for life, with remainder over, the surplus profits which have accumulated in the life-time of the testator, but which are not divided until after his death, belong to the *corpus* of his estate; while the dividends of earnings made after his death are income, and are payable to the life-tenant, no matter whether the dividend be in cash, or scrip, or stock."[1]

§ **2195. Illustration of this Rule.** — To illustrate this rule from the leading case in Pennsylvania, as restated in the latest case in that State[2] which has come under the eye of the author: The residuary estate of Robert Earp, who died in November, 1848, embraced stock in a manufacturing company, upon which large surplus profits, over and above the current dividends, had accumulated, both before and after his decease. In July, 1854, the capital stock was increased from $200,000, to $500,000, by creating 6,000 additional shares of $50 each, which were paid for out of the accumulations. At the testator's death, these surplus profits were near $300,000. When the stock was issued, they had increased to $700,000. The market value of the stock at his death was $125 per share. When the new stock was issued its value was $80, but the number of shares belonging to the estate was 1,350, instead of 540. As the new shares were therefore in part paid from the surplus existing at the death of Robert Earp, and partly from the accumulations after his death, they were properly apportioned between the life tenant and those entitled in remainder. It was held (*a*) that the surplus profits accumulated at the death of the testator, as respects the estate, were essentially a part of the stock itself, and were subject to the trusts in the will as so much principal; and (*b*) that the accumulations after his decease, when they come to be divided, were income, in like manner as the current dividends, and therefore belong to the life tenant, no matter whether the division or distribution thereof be in cash or scrip or stock. "In this case," said Lewis, C. J., "the testator has not made a bequest of the stock itself to the appellants; on the contrary, he has given them only the income of it for life. Their interest commences after the death of the testator. They have no right what-

[1] Smith's Estate, 140 Pa. St. 340, 352, per Clark, J., following Earp's Appeal, 28 Pa. St. 368, which is the leading case in Pennsylvania on the question. Compare Moss' Appeal, 83 Pa. St. 264; *s. c.* 24 Am. Rep. 164; Biddle's Appeal, 99 Pa. St. 278; McKeen's Appeal, 42 Pa. St. 479; Vinton's Appeal, 99 Pa. St. 434; *s. c.* 44 Am. Rep. 116; Wiltbank's Appeal, 64 Pa. St. 256; *s. c.* 3 Am. Rep. 585;

[2] Smith's Estate, 140 Pa. St. 344; *s. c.* 23 Am. St. Rep. 237; 48 Phil. Leg. Int. 176; 22 Pitts. L. J. (N. S.) 81; 27 W. N. C. 420; 21 Atl. Rep. 438.

ever to claim the income which had accumulated before his death. * * * It is equally clear that the profits arising since the death of the testator are income, within the meaning of the will, and should be distributed among the appellants."[1]

§ 2196. Question of Value how Determined Under Pennsylvania Rule. — Under the Pennsylvania rule, the question of *value* is to be determined, not by the fluctuations of the stock market, but by the actual assets held by the corporation.[2] "It is the *intrinsic value* of the shares, to be ascertained from the amount and value of the assets at the death of the testator, and at the time of the increase of the stock which governs in the apportionment of the surplus profits. The market value may aid in the ascertainment of the actual value, and is therefore properly received in evidence on that issue."[3]

§ 2197. Application of the Pennsylvania Rule Where Life-Tenant Dies before the Declaration of Dividend. — In the last case in Pennsylvania which seems to have been decided on this question, the life-tenant died before the declaration of the dividend, and the contest therefore arose between his administrator and the guardians of his children, who, as the remainder-men, were entitled to the *corpus* of the estate. It nevertheless called for the application of the principle which was declared in Earp's Appeal, under the following state of facts: — The testator died in October, 1884. By his will he gave a portion of his estate, in trust, to pay the net income to his son Alonzo Smith, free from his debts, for life, with remainder over to his children, etc. Included in this part of his estate were 56 shares of the capital stock of a railway company. The whole capital stock of the company was $750,000, that is to say, 15,000 shares of the par value of $50 per share. On the 4th of December, 1888, more than four years after the death of the testator, it was agreed, at a meeting of the stockholders, to issue 5,000 shares additional, at the par value of $50 per share, — the existing stockholders, as they were registered on January 2nd, 1889, to have the right, at any time before February 2d, thereafter, to subscribe one share for every three of their respective holdings on the day designated. The trustees of the estate in question exercised the privilege and bought eighteen shares, for $900, which money, for the time, they

[1] Earp's Appeal, 28 Pa. St. 368, 374.

[2] Smith's Estate, 140 Pa. St. 344, 357; *s. c.* 23 Am. St. Rep. 237; Moss' Appeal, 83 Pa. St. 364; Biddle's Appeal, 99 Pa. St. 278.

[3] Smith's Estate, *supra*.

borrowed from the income fund in their hands, subsequently making it good in their account and treating it as so much taken from the capital. On the 18th of February, 1889, the directors of the corporation declared a dividend of $11 per share on the whole 20,000 shares, including the old stock and the new issue. This dividend was made exactly to cover the price of the extra shares, less the State and city taxes, as follows: —

Subscription to 5,000 shares at $50	$250,000
Less State and city taxes, about	30,000
Dividend on 20,000 shares at $11	$220,000

In the meantime, on the 12th of January, 1889, Alonzo Smith, the life-tenant, died, leaving to survive him two minor children. The dividend on the 74 shares yielded to the estate $814. This dividend, it will be perceived, was declared after the decease of Alonzo Smith, and was applied by the trustees to those entitled in remainder. Upon a sale of the 18 new shares for which the trustees had subscribed, they realized a profit of $3,870, for which they accounted as capital. To this method of accounting the administrator of the deceased life-tenant excepted, claiming that this sum must be treated as income, and that, as such, it constituted a part of the assets of that estate. The auditing judge, as well as the Orphan's Court, held this $3,870 to be capital, and not income; and the Supreme Court affirmed this decision. The court re-affirmed the Pennsylvania rule started in Earp's Appeal,[1] as a salutary rule, but admitted that it was more difficult of application than the Massachusetts rule. Mr. Justice Clark, in giving the opinion of the court, said that, to adopt the contrary conclusion, would be to overrule the whole line of Pennsylvania cases and to adopt a method of distribution which wholly ignores the rights of the parties and defeats the just and clear purpose of the testator. "For it is perfectly plain," continued he, "that the value of the stock at the testator's death was composed in part of the accumulated profits. If the trustees, in order to change the investment, had, at the testator's decease, sold the shares, they would have received their value as affected by the surplus then undivided, and the amount received would, in that case, have been the principal upon which the life tenant would be entitled to receive income. Upon what principle of justice, then, should the act of the corporation, over which the parties had no control, be allowed to affect their rights, by taking from the remainder-men that which clearly belongs to them and handing it over bodily to the corporation?" Applying this rule to

[1] 28 Pa. St. 368.

the case in judgment, the learned judge continued: "The original capital of the company was $750,000; the new stock increased this to $1,000,000. The cost of construction and equipment of the road represented about $1,020,000. The testator died in October, 1884: on the 1st of January following the assets were $1,118,147.59; and on the 1st of January, 1889, which was before the stock issued, the assets were $1,126,344.53. It is certain then that the profits of the business were, with the amount of the new stock, applied to betterments and were thus actually capitalized in the testator's life-time. Under the Pennsylvania rule, therefore, when they come to be distributed, they should go to the principal, and not to the income." He then adopted the following language of the auditing judge: "The whole effect of the transaction in dispute was to enable the owners of the original shares, among whom are the parties in remainder, to realize upon their holdings what the shares were actually worth. It went upon the theory that the shareholders owned all the property of the corporation, but their stock did not properly set forth the ownership, and to the extent that it failed to represent the full value of such ownership, it was unavailable. By the new issue the whole capital was made marketably available. It worked no injustice to the life tenant; he got a dividend on the new shares as well as the old, and he was better off than before."[1]

§ 2198. Profits Accruing from a Discovery of Mineral After the Death of the Shareholder.— A curious application is given to the Pennsylvania rule by a recent case, in which the deceased was a shareholder in an *unincorporated land company*, which seems to have been organized for the purpose of investing in land under a scheme by which the members were not tenants in common of the land owned by the company, but were merely entitled to any profit accruing from the company's operation in the land which it owned. The chief object of the company seems to have been to make a profit by dealing in lands. A testator, in his life time, owned 5582 shares of the stock of this company. These shares were, in the aggregate, listed, in the inventory of his estate, at the nominal sum of $5.00. Two years afterwards, a lode of copper ore was discovered upon the land, and the usual "boom" followed, under which the directors of the company sold a small portion of the land for a sum so large that they were enabled to declare a cash dividend of $19.50 per share, amounting, upon the shares held by the trustees of the deceased member, to the sum of $108,849. It was held that this enormous dividend, although amounting to more than 1,000 per cent. upon the capital, must go to the life tenant and not to the re-

[1] Smith's Estate, 140 Pa. St. 344, 356, 357; *s. c.*, 23 Am. St. Rep. 237.

mainder-man. It was income, and not a part of the *corpus* of the estate, within the rule in Earp's appeal.[1] It must be regarded as *earned* when the profit on the sale of the land accrued, although due to the discovery, or supposed discovery, of minerals which existed in the land prior to the death of the testator, and although that discovery had not been made by the company itself. The court reasoned that the discovery might, on ordinary experience in such matters, be fictitious or greatly exaggerated; that the value at which the land was sold, in consequence of the supposed discovery, might not be an intrinsic value at all, such as inhered in the land prior to the death of the testator; and that, for aught that could be known, the land might relapse to its former value. The profit was earned by the fortunate sale of the land, and did not exist in the land itself. Such was the substance of the reasoning, though the writer does not undertake to state it in the language of the court.[2]

§ 2199. View that Extra Dividends, Bonuses, etc., Declared from Profits go to the Life-Tenant. — Many courts take substantially this view, and, looking through the mere *form* of corporate action to the *substance* and regardless of the question whether the particular dividend has been declared in cash, in scrip or in new shares, inquire whether it is a dividend arising from earnings or profits, or from the capital of the company. If it is found that it has arisen from earnings or profits, it goes to the life-tenant, although it is a dividend of new shares;[3] but if it is found that it is a dividend of the capital of the company, it will go to the remainder-man, although it has been declared in cash.[4] This rule is generally known in America as *the Pennsylvania rule*. The early English rule was that *extra dividends*,

[1] 28 Pa. St. 368.

[2] Re Oliver's Estate, 136 Pa. St. 43; *s. c.* 20 Am. St. Rep. L. R. A. 421; 26 W. N. C. 392; 21 Pitts. L. J. (N. S.) 115; 47 Phil. Leg. Int. 535; 20 Atl. Rep. 527.

[3] Clarkson *v.* Clarkson, 18 Barb. (N. Y.) 646; Simpson *v.* Moore, 30 Barb. (N. Y.) 638; Woodruff's Estate, 1 Tuck. (N. Y. Surr.) 58; Re Pollock, 3 Redf. (N. Y. Surr.) 100; Van Doren *v.* Olden, 4 Green (N. J.), 117; Ashhurst *v.* Field, 11 Green (N. J.), 1; Van Blarcom *v.* Dager, 4 Stew. (N. J.) 783; Lord *v.* Brooks, 52 N. H. 72; Pierce *v.* Burroughs, 58 N. H. 302; Earp's Appeal, 28 Pa. St. 368; Wiltbank's Appeal, 64 Pa. St. 256; *s. c.* 3 Am. Rep. 585; Biddle's Appeal, 99 Pa. St. 278; Vinton's Appeal, 99 Pa. St. 434; *s. c.* 44 Am. Rep. 116. The New York decisions above cited seem to be overruled by Re Kernochan, 104 N. Y. 618.

[4] Moss's Appeal, 83 Pa. St. 264; *s. c.* 24 Am. Rep. 164.

or additions to the usual annual dividend, whether paid in cash or in capital stock, went to the *corpus* of the trust.[1] But this rule was abandoned as unjust, and it is now uniformly held in that country,[2] and frequently in this country,[3] that cash dividends, extra dividends, or bonuses, declared from the earnings, are to be regarded as income, and go to the life-tenant. And such is the rule, although the dividends or bonuses were earned before the creation of the trust, but declared afterwards.[4] It seems to be conceded that the mere *name* by which the dividend is called by the directors, at the time when they declare it, cannot affect its quality, or of itself determine whether it is a part of the *corpus* of the estate or income. It has accordingly been held that the life-tenant, under a will of shares in a company, is entitled to a dividend paid from the profits of the company, although it was called "a *special bonus*" in the resolution to declare it, and although part of it may have come from a reserve fund which represented profits, where the directors had power to declare dividends, as well as to set aside a reserve fund and also to declare and pay interim dividends.[5] So, where the directors of a banking corporation passed a resolution to reduce the capital stock of the bank from $800,000 to $400,000, by returning to the stockholders $400,000 of the capital together with a premium of forty per cent. thereon, payable out of the surplus profits, — it was held that this premium of forty per cent. went to the life-tenant and not to the remainder-man, of an estate invested in these shares. It was clear to Mr. Surrogate Coleman that this was to be treated as a dividend of the earnings, although called in the resolution of the directors a "*premium*."[6] The surrogate also reasoned that it was immaterial whether the earn-

[1] Brander *v.* Brander, 4 Ves. 801; Paris *v.* Paris, 10 Ves. 184; Witts *v.* Steere, 13 Ves. 363; Preston *v.* Melville, 11 Sim. 163; Hooper *v.* Rossiter, 13 Price, 774.

[2] Price *v.* Anderson, 15 Sim. 473; Johnson *v.* Johnson, 15 Jur. 714; Bates *v.* Mackinley, 31 Beav. 280; Murray *v.* Glasse, 17 Jur. 816; Cuming *v.* Boswell, 2 Jur. (N. S.) 1005; Wright *v.* Tucket, 1 Johns. &. H. 266.

[3] Cogswill *v.* Cogswill, 2 Edw. Ch. (N. Y.) 231; Ware *v.* McCandlish, 10 Leigh (Va.), 595; Read *v.* Head, 6 Allen (Mass.), 174.

[4] Bates *v.* Mackinley, 31 Beav. 280.

[5] Re Alsbury, 45 Ch. Div. 237.

[6] Re Warren's Estate (Surr. Ct.), 33 N. Y. St. Rep. 584; *s. c.* 11 N. Y. Supp. 787.

ings were made by the bank before or after the testator's death, adopting in this respect the Massachusetts rule.

§ 2200. Under Massachusetts Rule Dividends Accruing During the Life of the Life-Tenant, but not Declared until After his Death, Pass to Remainder-Man. — Contrary to the rule in Pennsylvania, under the Massachusetts rule, dividends on corporate stocks belonging to an estate, which are declared after the death of the life-tenant, pass to the remainder-man as a part of the *corpus* of the estate, although in point of fact they represent profits which accrued prior to his death.[1] This is exactly contrary to the Pennsylvania holdings, already referred to,[2] and proceeds chiefly upon the difficulty of making an apportionment of dividends in such a case. "It would be impracticable," says Clark, J., "in many cases, and perhaps impossible in some cases, to determine the amount of net earnings at a given time, with any degree of accuracy; and hence the earnings and acquisitions are treated as mere incidentals to the capital stock, and undistinguishable and inseparable from it, until set apart by the declaration of a dividend, when they became dividend as distinguishable from capital." [3]

§ 2201. Ordinary Cash Dividends Go to Life-Tenant.—Keeping in mind the foregoing principles, there is a strong presumption that cash dividends, declared while the corporation is a going concern, are dividends of profits or earnings merely; for a corporation has no power to declare a dividend of its capital except in liquidation, or to reduce its capital where it is authorized to do so by its governing statute. There is no difficulty in holding, then, that an ordinary cash dividend of a going corporation, goes to the life-tenant, and not to the remainder-man, if he is the beneficial holder of the stock *at the time* when it is declared.[4] In so holding, the Supreme Judicial Court of Maine, speaking through Mr. Justice Peters, say: "The decided preponderance of authority probably concedes the point that divi-

[1] Quinn *v.* Madigan, 65 N. H. 8; *s. c.* 17 Atl. Rep. 976.

[2] *Ante,* § 2194.

[3] *Ibid.* This seems to be the rule in New York. Re Warren's Estate (Surr. Ct.), 33 N. Y. St. Rep. 584; *s. c.* 11 N. Y. Supp. 787.

[4] *Ante,* § 2172.

dends of stock go to the capital, under all ordinary circumstances. But we are well convinced that the general rule, deducible from the latest and wisest decisions, declares all money dividends to be profits and income, belonging to the tenant for life, including not only the usual annual dividend, but all extra dividends or bonuses payable in cash from the earnings of the company. We are satisfied that this can be the only safe, sound, just and practicable rule, and that any attempt to engraft refined and nice distinctions upon such rule will be productive of much more evil than any good that can come from it. And we would entirely reject the qualification of the rule, admitted in some instances by some courts, that the life-tenant is not entitled to so much of the dividend as was earned in the life-time of the testator. Too much difficulty and uncertainty would attend the practical operation of such a test. Nor do we appreciate any particular legal or moral merit in it. We think the true rule to be that when a dividend upon its stock is declared by a corporation, it belongs to the person holding the stock at the time of the declaration, whether the holder be a life-tenant or remainder-man, without regard to the source from which or the time during which the profits and earnings divided were acquired by the company." [1]

§ 2202. **Illustrations.** — Thus dividends made in cash by a manufacturing corporation, though made out of money received from the sale of patent rights and a large amount of materials, have been held income and not capital.[2] So, cash dividends made by a land company, whose business is the sale of lands which are the corporate property, have been held, in the absence of any facts necessarily pointing to the contrary conclusion, to be income, and not capital of a trust fund created by the will of a stockholder.[3]

§ 2203. **Dividend Payable Out of Old Shares.** — And where a dividend, declared to be made out of the earnings of the corporation, is not made in the form of cash, but in *old shares* of the corporation itself, in which it has invested the amount, it has been held *income* of the shares previously held by the stockholders.[4]

[1] Richardson *v.* Richardson, 75 Me. 570; *s. c.* 46 Am. Rep. 428.

[2] Harvard College *v.* Amory, 9 Pick. (Mass.) 446.

[3] Balch *v.* Hallett, 4 Gray (Mass.), 202; Reed *v.* Head, 6 Allen (Mass.), 174.

[4] Leland *v.* Hayden, 102 Mass. 542.

§ 2204. Cash Dividend Voted to Pay Invalid Stock Dividend. — Where the directors of a corporation vote a *cash dividend* for the purpose of paying for new stock to be issued to its stockholders, the whole transaction constituting a stock dividend, if the issue of the stock is void because of non-compliance with the provisions of a statute, the cash dividend will fall also, and cannot be claimed by a person entitled to the income of certain shares of stock.[1]

§ 2205. Shares Reduced in Consequence of Losses and Then Re-issued After Recovery. — Where a banking corporation lawfully reduced the par value of its shares, in consequence of certain supposed losses, and, upon recovery of the sum supposed to have been lost, issued additional stock to its shareholders to represent the restored value, — it was held that the new stock thus issued belonged to the *corpus* of the estate of a deceased shareholder, and did not go to the life-tenant.[2] This conclusion would plainly have followed either under the Massachusetts or the Pennsylvania rule.

§ 2206. What Dividends Pass to the Specific Legatee of Shares.— Under the foregoing principles, a specific legatee of corporate shares is entitled to all dividends which are *declared* after the death of the testator.[3] To this rule one English case adds the qualification that a dividend earned before the death of the testator and which *ought to have been declared* before, goes to the *corpus* of his estate, and does not follow the shares to the specific legatee.[4] Another English case holds that dividends *payable* after the death of the testator go to the specific legatee, although the resolution declaring them may have been passed in the testator's life-time.[5] Although this case is said by Sir Nathaniel Lindley[6] to have turned on the special wording of the company's deed of settlement, yet it reaches the result which would be reached in most American courts in respect of ordinary dividends. The rule, elsewhere stated,[7] that the severance of title in respect of the dividend takes place at the date when it is

1 Rand *v.* Hubbell, 115 Mass. 461; *s. c.* 15 Am Rep. 121.

2 Parker *v.* Mason, 8 R. I. 427.

3 Jacques *v.* Chambers, 2 Coll. 435; Wright *v.* Warren, 4 De Gex & S. 367; Browne *v.* Collins, L. R. 12 Eq. 586; Ibbotson *v.* Elam, L. R. 1 Eq. 188.

4 Browne *v.* Collins, *supra.*

5 Clive *v.* Clive, Kay, 600.

6 Lind. Comp. Law, 5th ed., 545, note *i.*

7 *Ante*, § 2172.

declared without reference to the date when it is made payable, would take it to the general estate if it were declared prior to the death of the testator, and to the specific legatee if declared after his death. Most of the English cases conform to this theory, and unite in holding that dividends declared before the death of the testator belong, *prima facie*, to his general estate, and do not pass to a specific legatee, although he may die before the date at which they are payable.[1]

§ 2207. View that the Question is to be Determined by the Form of Corporate Action.— Another view is that the question is to be determined by the form of the action of the corporation,— the courts sometimes say *intent* and *substance*, but they really mean *form*. The meaning of it is this: that whatever the corporation chooses to call capital and to treat as capital, becomes for that reason capital as between the life-tenant and remainder-man, and goes to the latter, although derived from its profits; and on the other hand, whatever it may choose to distribute as ordinary dividends while it is a going concern, is to be regarded as profits, and is to go to the life tenant, although it may in fact be a dividend of its capital, and although its payment may in fact impair to that extent its permanent capital. This, substantially, is the view taken by the Supreme Judicial Court of Massachusetts. That court have reasoned that, although money in the hands of the directors may be income *to the corporation*, yet it is not income *to a stockholder* until a dividend is declared. When, therefore, the company invests such money in buildings and machinery, or in railroad tracks, depots, rolling stock, or any other permanent improvements, for enlarging or carrying on their legitimate business, it never becomes income to the shareholder. The investment becomes an accretion to the capital, and it is equally so whether they increase the number of shares, or the par value of shares, or leave the shares unaltered. Or if the number of shares is increased for purposes merely speculative, it is an increase of capital stock, and not of income, and it would be practically unwise for courts to go behind the action of the company and

[1] De Gendre *v.* Kent, L. R. 4 Eq. 283; Lock *v.* Venables, 27 Beav. 598; Wright *v.* Tuckett, 1 Johns. & H. 266; Clive *v.* Clive, Kay, 600.

attempt to ascertain how they came by the funds out of which they declare either cash or stock dividends.[1] The same court has reiterated this view in a later case, by saying in substance that whether the distribution, by a corporation, of its earnings among its stockholders, is an apportionment of stock, or a dividend of profits, depends upon the *substance and intent of the action of the corporation*, as shown by its votes. It is also repeated that "it would be impracticable for the courts, in determining the comparative rights of different persons in a particular share of stock, to go behind the votes of the corporation and its directors, and investigate the accounts and affairs of the corporation, in order to ascertain how the corporation acquired the funds out of which the dividend was declared."[2]

§ 2208. Result of this View: Cash Dividends, However Large, Income; Stock Dividends, However Made, Capital.— The logical result of this doctrine is that cash dividends, however large, are income and go to the life-tenant; and that stock dividends, however made, are capital and go to the remainder-man.[3]

§ 2209. Another Result; Undivided Earnings Likewise Capital.— Another result of this view is that undivided earnings of the corporation are likewise regarded as capital; and hence that, as between the life-tenant and remainder-man, the interest in such earnings represented by each certificate of stock is an interest in the capital, and not an interest in the income.[4] Moreover, as the corporation may, in the absence of a restraining statute, treat its undivided earnings either as capital or income, — that is, turn them into its property or business or

[1] Minot *v.* Paine, 99 Mass. 101; *s. c.* 96 Am. Dec. 705.

[2] Rand *v.* Hubbell, 115 Mass. 461; *s. c.* 15 Am. Rep. 121, 134. That the question is to be determined by votes of the corporation, see Leland *v.* Hayden, 102 Mass. 550; Adams *v.* Adams, 139 Mass. 452.

[3] Minot *v.* Paine, 99 Mass. 101; *s. c.* 96 Am. Dec. 705; Daland *v.* Williams, 101 Mass. 503; Leland *v.* Hayden, 102 Mass. 550; Adams *v.* Adams, 139 Mass. 452. Compare Heard *v.* Eldredge, 109 Mass. 260; *s. c.* 12 Am. Rep. 681; Sohier *v.* Burr, 127 Mass. 225; Hooper *v.* Rossiter, 1 McClel. 527; Barton's Trust, L. R. 5 Eq. 238; Balch *v.* Hallett, 10 Gray (Mass.), 403.

[4] Gifford *v.* Thompson, 115 Mass. 480; Rand *v.* Hubbell, 115 Mass. 461; *s. c.* 15 Am. Rep. 121, 134.

distribute them in cash dividends,[1] — it follows that it may, during the entire life of the life-tenant of its shares, turn its earnings into capital and issue stock dividends to represent the increase, which dividends, under the operation of this rule, will be reserved for the remainder-man, leaving the life-tenant to starve and defeating the plain intent of the testator.

§ 2210. Continued: Stock Dividends Capital, although Derived from Net Earnings. — It results from this view that when the vote of the corporation is to distribute to each stockholder a certain number of additional shares in the corporation, in proportion to the amount of shares already held by him, the shares so distributed are received by the stockholder as capital, and not as income, although the means of making the dividend are derived from the net earnings of the corporation; and hence, if such new shares go to the trustee in such a trust as we are considering, he must hold them for the remainder-man.[2] If, therefore, a *joint-stock association* increases its capital stock, to represent profits actually invested in extending its business and increasing the value of its plant, and apportions the new shares pro rata among its existing shareholders, the new shares become capital and not income, for the purposes of such a trust as those under consideration.[3]

§ 2211. View of the Supreme Court of the United States. — The Supreme Court of the United States has thrown the weight of its great authority in favor of the Massachusetts doctrine, in a recent opinion pronounced by Mr. Justice Gray, without any dissent. The court hold that stock dividends are a part of the *corpus* of such a trust estate as that under consider-

[1] Rand *v.* Hubbell, *supra.*

[2] Gibbons *v.* Mahon, 136 U. S. 549; *s. c.* 10 Sup. Ct. Rep. 1057; Minot *v.* Paine, 99 Mass. 101; *s. c.* 96 Am. Dec. 705; Rand *v.* Hubbell, 115 Mass. 461; *s. c.* 15 Am. Rep. 121, 135; Atkins *v.* Albree, 12 Allen (Mass.), 359; Daland *v.* Williams, 101 Mass. 571; Leland *v.* Hayden, 102 Mass. 542; Gifford *v.* Thompson, 115 Mass. 478; Brinley *v.* Grou, 50 Conn. 66; *s. c.* 47 Am. Rep. 618; Greene *v.* Smith (R. I.), 19 Atl. Rep. 1081; Brown's Petition, 14 R. I. 371; *s. c.* 51 Am. Rep. 397; Richardson *v.* Richardson, 75 Me. 570, 574; *s. c.* 46 Am. Rep. 428; Barton's Trust, L. R. 5 Eq. 238, 243; Sproule *v.* Bouch, 29 Ch. Div. 635; Bouch *v.* Sproule, 12 App. Cas. 385. Compare Re Kernochan, 104 N. Y. 618.

[3] Spooner *v.* Phillips, 62 Conn. 62; *s. c.* 24 Atl. Rep. 524.

ation, without reference to the question whether they accrue from earnings or accumulations made before or after the death of the testator. The following extract from the opinion will show the principles upon which the court proceed: "The distinction between the title of a corporation, and the interest of its members or stockholders, in the property of the corporation, is familiar and well settled. The ownership of that property is in the corporation, and not in the holders of shares of its stock. The interest of each stockholder consists in the right to a proportionate part of the profits whenever dividends are declared by the corporation, during its existence under its charter, and to a like proportion of the property remaining, upon the termination or dissolution of the corporation after payment of its debts.[1] Money earned by the corporation remains the property of the corporation, and does not become the property of the stockholders, unless and until it is distributed among them by the corporation. The corporation may treat it and deal with it either as profits of its business, or as an addition to its capital. Acting in good faith and for the best interests of all concerned, the corporation may distribute its earnings at once to the stockholders as income; or it may reserve part of the earnings of a prosperous year to make up for a possible lack of profits in future years; or it may retain portions of its earnings and allow them to accumulate, and then invest them in its own works and plant, so as to secure and increase the permanent value of its property. Which of these courses shall be pursued is to be determined by the directors, with due regard to the condition of the company's property and affairs as a whole; and, unless in case of fraud or bad faith on their part, their discretion in this respect cannot be controlled by the courts, even at the suit of owners of preferred stock, entitled by express agreement with the corporation to dividends at a certain yearly rate, in preference to the payment of any dividend on the common stock, but dependent on the profits of each particular year, as declared by the board of directors.[2] Reserved and accumulated

[1] Citing Van Allen *v.* Assessors, 3 Wall. (U. S.) 573, 584; Delaware Railroad Tax, 18 Wall. (U. S.) 206, 230; Tennessee *v.* Whitworth, 117 U. S. 129, 136; New Orleans *v.* Houston, 119 U. S. 265, 277.

[2] Citing New York &c. Railroad *v.* Nickals, 119 U. S. 296, 304, 307.

earnings, so long as they are held and invested by the corporation, being part of its corporate property, it follows that the interest therein, represented by each share, is capital, and not income, of that share, as between the tenant for life and the remainder-man, legal or equitable, thereof. Whether the gains and profits of a corporation should be so invested and apportioned as to increase the value of each share of stock, for the benefit of all persons interested in it, either for a term of life or of years, or by way of remainder in fee, or should be distributed and paid out as income, to the tenant for life or for years, excluding the remainder-man from any participation therein, is a question to be determined by the action of the corporation itself, at such times and in such manner as the fair and honest administration of its whole property and business may require or permit, and by a rule applicable to all holders of like shares of its stock; and cannot, without producing great embarrassment and inconvenience, be left open to be tried and determined by the courts, as often as it may be litigated between persons claiming successive interests under a trust created by the will of a single shareholder, and by a distinct and separate investigation, through a master in chancery or otherwise, of the affairs and accounts of the corporation, as of the dates when the provisions of the will of that shareholder take effect, and with regard to his shares only. In ascertaining the rights of such persons, the intention of the testator, so far as manifested by him, must of course control; but when he has given no special direction upon the question as to what shall be considered principal and what income, he must be presumed to have had in view the lawful power of the corporation over the use and apportionment of its earnings, and to have intended that the determination of that question should depend upon the regular action of the corporation with regard to all its shares. Therefore, when a distribution of earnings is made by a corporation among its stockholders, the question whether such distribution is an apportionment of additional stock representing capital, or a division of profits and income, depends upon the substance and intent of the action of the corporation, as manifested by its vote or resolution; and ordinarily a dividend declared in stock is to be deemed capital, and a dividend in money is to be deemed income, of each share.

A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interests of the shareholders. Its property is not diminished, and their interests are not increased. After such a dividend, as before, the corporation has the title in all the corporate property; the aggregate interests therein of all the shareholders are represented by the whole number of shares; and the proportional interest of each shareholder remains the same. The only change is in the evidence which represents that interest, — the new shares and the original shares together representing the same proportional interest that the original shares represented before the issue of new ones."[1]

§ **2212. English Expressions of the Same View.** — This is in conformity with frequent expressions of doctrine in England. Thus, it was said by Vice-Chancellor Shadwell: "The question must be determined by the mode in which the company have dealt with their profits."[2] Again, it was said by Vice-Chancellor Sir W. Page Wood, afterwards Lord Hatherley: "As long as the company have the profit of the half year in their hands, it is for them to say what they will do with it, subject, of course, to the rules and regulations of the company." And again: "The dividend to which a tenant for life is entitled is the dividend which the company chooses to declare." And again: "Where the company, by a majority of their votes, have said that they will not divide its money, but turn it all into capital, capital it must be from that time."[3]

1 Gibbons *v.* Mahon, 136 U. S. 549, 557–60; affirming *s. c.* 4 Mackey (D. C.), 130.

2 Price *v.* Anderson, 15 Sim. 473, 477.

3 Re Barton's Trust, L. R. 5 Eq. 238, 243, 245. The question has given rise to great perplexity in the English equity courts. Sir N. Lindley throws many of the cases into contrast in a note, thus: "Compare (1) Hopkins' Trust, 18 Eq. 696; Plumbe *v.* Neild, 6 Jur. (N. S.) 529; Price *v.* Anderson, 15 Sim. 473; Preston *v.* Melville, 16 *Ib.* 163, and Barclay *v.* Wainright, 14 Ves. 66, in which the payments were held to be income, with (2) Straker *v.* Wilson, 6 Ch. 503; Barton's Trust, 5 Eq. 238; Warde *v.* Combe, 7 Sim. 634; Witts *v.* Steer, 13 Ves. 363; Paris *v.* Paris, 10 Ves. 185; Brander *v.* Brander, 4 Ves. 800, in which the payments were held to be capital. See also Cuming *v.* Boswell, 2 Jur. (N. S.) 1005, where the House of Lords held that, upon the true construction of a Scotch deed, bonuses belonged to an infant's estate, and not to the person who, on his death under twenty-one, became entitled to the stocks which yielded them." Lind. Comp., 5th ed. 545.

§ 2213. Profits Turned into Capital and afterwards Divided. — Two decisions of the House ot Lords sanction the view that if a company has no power to increase its capital, but accumulates profits, which it uses as capital, but which it afterwards divides among its shareholders, such divided profits are capital, and do not go to the life-tenant of the shares, but are held for the remainder-man.[1]

§ 2214. Premiums Accruing from the Sale of New Shares. — In like manner it has been held in Massachusetts that when a corporation votes to increase its capital stock, and to allow the holders of the old shares to subscribe for the new ones *pro rata*, and that any new shares not so taken shall be sold by the directors, and the premiums realized by the sale paid over to the parties entitled to the right of subscribing for the shares, — the sum received by the directors upon such sale is *capital* to the stockholder.[2] So, under the Pennsylvania rule, the profits accruing from a sale of shares of increased stock taken by trustees holding old stock, which gave them a right to take it, is capital, and not income, as between life-tenant and remainder-man.[3]

§ 2215. Profits Arising from Options to take New Shares. — And in Pennsylvania, where a different theory prevails,[4] it is held that, if the corporation increases its capital stock, and allows each shareholder the option of taking at par as many new shares as he held of the old, and the trustees under a will bequeathing the income, profit and products of certain stock in the company to a person for life with remainder over, sell a part of their option to take new shares and with the proceeds of such sale buy some of the new shares, these shares will be *capital*, and will go to the remainder-man. The view upon which this opinion proceeds is that the option to take new shares is not

[1] Irving *v.* Houstoun, 4 Paton Sc. App. 521; Bouch *v.* Sproule, 12 Ap. Cas. 385; reversing *s. c.* 29 Ch. Div. 635.

[2] Adkins *v.* Albree, 12 Allen (Mass.), 359.

[3] Smith's Estate, 140 Pa. St. 344; *s. c.* 48 Phil. Leg. Int. 176; 22 Pitts. L. J. (N. S.) 81; 27 W. N. C. 420; 21 Atl. Rep. 438. See this case set out in full, *ante*, § 2197.

[4] *Ante*, § 2196.

a profit.[1] This ruling seems hardly consistent with that in a previous case in the same court, where the facts were, that a testatrix by her will created a trust of the character of which we are speaking, and, after her death, two corporations in which she owned stock constituting a part of the trust estate, resolved to increase their capital by an issue of new stock to be subscribed and paid for by the existing stockholders. The trustees sold the right to subscribe for the stock in one company, and subscribed and paid with their own money for stock in another company. They sold the stock thus subscribed for at a premium, and credited the trust fund with the profits which they had realized in both cases. It was held that these profits belonged to the *income*, and not the capital of the trust.[2]

§ 2216. Further Illustration of the Massachusetts Rule.— Where, at the time of the creation of new shares to be distributed among the old stockholders, a dividend is declared *in cash* to the same amount, the thing received by each stockholder, whether in stock or in cash, is to be deemed *capital*, and not income, if such appears upon the face of the whole action of the corporation to be the real character of the transaction. Thus, if a corporation votes to create new shares and at the same time declares a dividend payable in cash to the stockholders, and authorizes its treasurer to receive this dividend in payment for such shares, and to issue certificates of stock in return, the dividend is, as between the owners of successive interests in the shares, capital and not income, although the corporation is not allowed by the law of the State in which it is established to make stock dividends.[3]

§ 2217. Further Illustration.—And so, where a corporation voted to create new shares, to be issued and disposed of as the directors should deem proper, and the directors voted to offer to each stockholder the right to take at par twenty per cent. of a new share for each old share held by him, and that if any one should not avail himself of his right, it should be at the disposal of the directors, and the directors, on the same day, declared a dividend of twenty per cent. in cash, derivable from the shares which the stockholders should respect-

[1] Moss's Appeal, 83 Pa. St. 264; *s. c.* 24 Am. Rep. 164.

[2] Wiltbank's Appeal, 64 Pa. St. 256; *s. c.* 3 Am. Rep. 585. See also Plumbe *v.* Neild, 6 Jur. (N. S.) 529; McLaren *v.* Stanton, 3 De J. F. & A. 202. Compare Wiltbank *v.* Insurance Co., 7 Phil. (Pa.) 327.

[3] Daland *v.* Williams, 101 Mass. 571.

ively pay for the new shares taken by them under the preceding vote, — it was held that a trustee holding stock in the corporation, whether he received the amount of his dividend in stock, or suffered the stock to which he was entitled to be sold by the directors and received the dividend *in cash*, took it, in either alternative, as capital, and not as income.[1]

§ **2218. Further Illustration.** — A corporation voted to increase the number of shares of its capital stock, so as to allow each shareholder to increase the number of shares held by him by one-half, and commanded the directors to do whatever was required by law for that purpose. The directors passed a vote on the same day, by which they declared that a dividend in cash should be payable to each stockholder at the time within which he was allowed, by the vote of the corporation, to take his new shares, and providing that the dividend should be applied by him in payment for those shares, and directed the treasurer to issue such shares to old stockholders only. Each stockholder received a check for the amount of his dividend, and immediately exchanged the check for a certificate of the shares apportioned to the stock held by him. The checks were then destroyed, and were not presented at the bank. Here, pursuant to the line of authority previously stated, the court held that the stock issued in compliance with the above votes, constituted a *stock dividend;* and that, in case of shares of old stock held by a trustee, the new shares must be considered an addition to the *capital* of the trust fund, and not as income.[2] But later the same court has held that a dividend representing earnings or profits is, as between a life-tenant and remainder-man, income and not capital, although permanent improvements have been previously made to an equal amount, and the dividend is exactly sufficient to pay for a voted increase in the capital stock, for which the stockholders are entitled to subscribe in proportion to the number of their shares.[3]

§ **2219. Increase in Value of Shares is Capital.** — It follows that the enhanced price for which stocks may sell by reason of dividends earned but not declared, inures, under the *modern rule*, to the benefit of the *remainder-man*.[4] So, where the corporation, upon increasing its capital stock, issues new shares in

[1] Leland *v.* Hayden, 102 Mass. 542; *s. c.* 3 Am. Rep. 502.

[2] Rand *v.* Hubbell, 115 Mass. 461; *s. c.* 15 Am. Rep. 121.

[3] Davis *v.* Jackson, 152 Mass. 58; *s. c.* 8 Rail. & Corp. L. J. 246; 25 N. E. Rep. 21.

[4] Scolefield *v.* Redfern, 32 L. J. (Ch.) 627; *s. c.* 2 Dr. & Sm. 182.

exchange for its old ones,— these new shares are not regarded as income, but go to the remainder-man.[1] The life-tenant in such a case is not entitled to so much as represents the surplus earnings between the death of the testator and the offer of the new stock, but only to the dividends so long as they are duly declared.

§ 2220. Cash Dividend Declared Out of Capital Goes to Remainder-man.— But this rule is, by reason of the principle on which it rests, limited to dividends of profits or earnings merely. It is entirely consistent with the governing principle to hold that if a *cash dividend* is declared from a *sale of the franchises and permanent property* of the corporation, it will be regarded as capital and will go to the remainder-man, notwithstanding the form in which it was declared.[2] An inaccurate and partial application of the same principle, and one in accordance with the Massachusetts theory, already considered, of considering the form of the dividend merely, has resulted in the holding that, when a corporation dissolves and winds up its affairs, and makes to its stockholders a dividend in cash, arising from all its assets, *consisting in part of undivided earnings*, the entire amount divided will be capital and not income.[3] Here, the governing principle to which the author appeals would require so much of the dividend as consisted of undivided earnings, to go to the life-tenant.[4]

§ 2221. Dividend from Expropriation of Real Estate of Corporation. — It has been ruled that where the property of a corporation consists wholly of real estate and a part of it is taken under the right of eminent domain, and the compensation paid to the corporation therefor is by it distributed as a cash dividend to its shareholders, such a dividend belongs to the capital, and not to the income of a trust fund invested in the

[1] Greene *v.* Smith, 17 R. I. 28.

[2] Moss's Appeal, 83 Pa. St. 264; *s. c.* 24 Am. Rep. 164; Vinton's Appeal, 99 Pa. St. 434; *s. c.* 44 Am. Rep. 116.

[3] Gifford *v.* Thompson, 115 Mass. 478.

[4] Stock dividends arising from the sale of *a part of the assets* of a corporation, being capital, and not income, belong to the remainder-man, and not to the life-tenant. Re Curtis (Surr. Ct.), 29 N. Y. State Rep. 217.

shares.[1] This decision is a flat denial of the doctrine laid down by the same court, in an opinion written by the same judge,[2] in the leading case on the subject, where the court said: "The simple rule is to regard cash dividends, however large, as income; and stock dividends, however made, as capital."[3] It also illustrates the gross injustice of the Massachusetts rule. In the case under consideration, a wharf company had a wharf, dock and warehouse, from which it derived an income. The city of Boston took a part of this real estate in laying out a new street, and paid it $185,000 therefor, of which the company divided $75,000 in cash among its stockholders, and $4,350 of this went to a shareholder who was trustee in a will creating such a trust as we are considering. It was held that only the profit or interest acccuing from re-investment by the trustee of the dividend so received could go to the life-tenant. But under the ruling in the leading case above quoted that "a stock dividend however made is capital," if, instead of acquiring this $75,000 from an expropriation of some of its real estate, it had accrued to the company from the earnings of the preceding six months, and the company had held it in its treasury and had elected, instead of dividing it, to issue a stock dividend in respect of it, this dividend would *also* have been capital to go to the remainder-man. This case shows that the Massachusetts court *does not* allow the question to be determined by the vote of the corporation, as it professes to do, but does go behind the form in which the dividend is declared, and does inquire whether it was in fact declared out of earnings or out of capital. But it seems to do this for the benefit of the remainder-man only — not for the protection of the life-tenant.

§ **2222. The Massachusetts Doctrine Criticised.** — The Massachusetts doctrine seems to be a rule of mere convenience, and not a rule of justice. It loses sight of the real question under consideration, what is *capital of the estate* disposed of by the will, and not what is capital of the corporation; and it goes entirely beyond tenable ground where it allows this ques-

[1] Heard *v.* Eldredge, 109 Mass. 258; *s. c.* 12 Am. Rep. 687.

[2] Chapman, C. J.

[3] Minot *v.* Paine, 99 Mass. 101; *s. c.* 96 Am. Dec. 705.

tion to be determined, not by the judicial courts upon a view of the real substance of the case, but by a board of directors, that is, by a committee of persons entirely foreign to the will, in passing a resolution declaring a dividend. A testator disposes of his estate upon a trust that the income shall go to his widow, and the capital to his children. The estate is invested in the shares of a railway company. The railway company, instead of declaring cash dividends, declares stock dividends; and thus, by the mere will of its board of directors exerted to serve the interest of the corporation which they represent, and having no reference whatever to the carrying out of the trust of the will of the decedent, both the *corpus* and its income are saved for the children, while the widow is allowed to starve. It has been also pointed out that the Massachusetts court have found it impossible to carry out the rule which they first declared, which left the matter to be determined by the substance and intent of corporate action. They have been obliged to hold that a cash dividend made from the expropriation of a portion of the company's property is capital and must go to the remainder-man, although the dividend was declared while the company was a going concern, — thus making the question depend on the *source* from whence the dividend was derived;[1] but they have steadily refused to apply the same principle where the dividend consisted of new shares which merely represented income earned but not divided in cash.[2]

§ **2223. Rule Under Georgia Code.**— The code of Georgia enacts that "the natural increase of the property belongs to the tenant for life. Any extraordinary accumulation of the corpus, such as an issue of new stock upon the share of an incorporated or joint-stock company, attaches to the corpus and goes with it to the remainder-man."[3] The application of this statute to the provisions of a will illustrates in an apt degree the inconvenience of the legislature attempting to interpret wills by the enactment of a statute. It was held that dividends of the capital stock of a railway company amounting in one case to $40.00 per share and in another to $32.00 per share, went to the life-tenant and not to the remainder-man. Such dividends were

[1] *Ante*, § 2221.

[2] *Ante*, § 2216, *et seq.*

[3] Code of Georgia, ed. of 1873, § 2256.

the "natural increase," and not "the extraordinary accumulation of the corpus," within the meaning of the above statute.[1]

Article VI. Remedies to Compel Payment of Declared Dividends.

§ 2227. Stockholder Cannot Sue for a Dividend until Declared. — From what has preceded,[2] it follows that, except in the case of preferential or guaranteed stock,[3] a stockholder can not sue the corporation for his share of accumulated profits until a dividend has been declared — a matter within the discretion of the directors, and which the courts will not in general control.[4]

§ 2228. But May when Dividend has been Declared. — But when a dividend has been declared it becomes a *debt* due from the corporation[5] to each stockholder in proportion to the number of his shares, and he may sue and recover the same at law.[6] The resolution declaring the dividend is a written admission on the part of the corporation of an indebtedness to each particular stockholder, payable in the legal currency of the country, unless otherwise specified in the resolution.[7] It follows that it will be no defense to such an action to show that the earnings of the corporation were received in property other than legal currency.[8] Nor can the corporation set up as a defense to such an action that

[1] Miller *v.* Guerrard, 67 Ga. 284; *s. c.* 44 Am. Rep. 720.

[2] *Ante*, § 2127.

[3] *Post*, § 2289, *et seq.*

[4] Beveridge *v.* New York El. R. Co., 112 N. Y. 1; *s. c.* 19 N. E. Rep. 489.

[5] Wheeler *v.* Northwestern Sleigh Co., 39 Fed. Rep. 347.

[6] Keppel *v.* Petersburg R. Co., Chase Dec. (U. S.) 167; Beers *v.* Bridgeport Spring Co., 42 Conn. 17.

[7] Scott *v.* Central &c. R. Co., 52 Barb. (N. Y.) 45; Ehle *v.* Chittenango Bank, 24 N. Y. 548.

[8] *Ibid.*

it has been compelled to part with its surplus funds in the payment of an illegal tax under duress of a threatened levy.[1]

§ 2229. **Limitation of Such Actions.** — Dividends declared on the capital stock of a corporation and payable on demand are not subject to the running *of prescription or limitation* until there has been a *demand* and *refusal.*[2] The reason is that, though the declaration of a dividend creates a *debt* of the corporation in favor of the stockholder, it is a debt payable only *on demand*, and has been compared to the obligation of a bank to its depositors.[3] Other cases rest their holdings upon the *trust relation* which exists between the company and its stockholders, which, in effect, amounts to the same thing;[4] for there must be an initial point at which the possession of the company becomes one *animo domini*.

§ 2230. **Remedy in Equity to Recover Dividend.** — Where a dividend has been declared, and the corporation afterwards attempts to re-appropriate it and refuses to pay it, it has been held that dissenting shareholders may invoke the aid of a court of equity to compel its payment. This holding proceeds on the principle, hereafter considered, that the directors of the corporation are trustees in theory of equity for the benefit of all the shareholders, and that if they act in disregard of the rights of a minority, equity will protect them.[5] In the case first cited the directors had declared a dividend of seventy per cent. to be credited to the stockholders *pro rata* and to

[1] Kimball *v.* Corn Exchange Nat. Bank, 1 Ill. App. 209.

[2] Armant *v.* New Orleans &c. R. Co., 41 L. A. An. 1020; *s. c.* 7 So. Rep. 35; St. Romes *v.* Levee Steam Cotton Press, 20 La. An. 381; Philadelphia &c. R. Co. *v.* Cowell, 28 Pa. St. 329, 339; *s. c.* 70 Am. Dec. 128; State *v.* Baltimore &c. R. Co., 6 Gill (Md.), 363, 387; Bank of Louisville *v.* Gray, 84 Ky. 565; *s. c.* 2 S. W. Rep. 168. See also Keppel *v.* Petersburg R. Co., Chase Dec. (U. S.) 167, 213, where it is held that dividends being payable only on demand, *interest* can only be allowed from that date.

[3] Armant *v.* New Orleans &c. R. Co., 41 La. An. 1020; *s. c.* 7 So. Rep. 35. See also Brown *v.* Pike, 34 La. An. 576; *post*, § 2232.

[4] Bank of Louisville *v.* Gray, 84 Ky. 565: *s. c.* 2 S. W. Rep. 168.

[5] Beers *v.* Bridgeport Spring Co., 42 Conn. 17; Gordon *v.* Richmond &c. R. Co., 81 Va. 621.

be paid without interest at such time as should be directed by the board, and certain shareholders sued in equity to compel its payment. It was held that the corporation could not withhold the payment of the dividends, but must pay them within a *reasonable time*, and that the stockholders were entitled to the aid of equity to compel their payment. It was shown by way of defense that the directors had declared several dividends upon the same terms, and from profits actually received, amounting in the whole to 115 per cent., besides sundry dividends which were paid to the stockholders. It was found that the company had no more cash funds than sufficient to carry on its ordinary business and pay such dividends as it was actually paying, and that the 115 per cent. had been invested in real estate and improvements in machinery, and in material required in the business, that no part of it had been lost, and that the directors had acted in good faith and according to their best judgment. But the court held that these facts did not constitute a sufficient reason for refusing the aid of equity to certain stockholders who demanded payment of the dividends in question, and that the corporation should be ordered to pay the same at such time or times as it should be found, on further inquiry, that they could be paid without serious injury to its business.[1]

§ 2231. Parties to Actions to Enforce Payment of Dividends. — Whatever may be the form of the proceeding to enforce the payment of a dividend, the corporation is, of course, a necessary party defendant, because, assuming that the dividend has been properly declared, it is the debtor.[2] It follows that such an action cannot be brought against its treasurer.[3] The obligation of a corporation is to pay the dividend to the *true owner* of the shares and to no one else. Hence, where an administrator illegally disposed of stocks at private sale, and the same were by his direction transferred on the books of the company, and it was not known to the heir who was the holder thereof, the compaay was held a necessary party defendant to a

[1] Beers *v.* Bridgeport Spring Co., 42 Conn. 17.

[2] *Ante*, § 2127.

[3] French *v.* Fuller, 23 Pick. (Mass.) 108.

bill filed *to discover the owner* of the stock, and praying a retransfer of the same and an account of the dividends.[1] The *holder* of the stocks is also a necessary party defendant in such a suit, and when discovered by the answer, must be proceeded against as holder, before any final decree can be had either as to the retransfer or the dividends.[2]

§ **2232. Demand.** — It may be assumed that, unless there is a statute dispensing with a demand in actions for the recovery of money, a stockholder must prove a demand before he can maintain an action for a dividend.[3]

§ **2233. Pending an Action for a Conversion of the Shares.**— One who has brought an action against the corporation for the conversion of his shares can not, while such action is pending, maintain an action against the corporation for dividends on the shares; nor can his assignee, who stands in his shoes, maintain such an action. The reason is that the two actions are inconsistent; the former proceeds on the ground that, through the tortious action of the corporation, he has *lost his title* to his shares, while the latter proceeds on the ground that he still has title and is hence entitled to dividends.[4] But he may proceed *in equity* to be restored to his rights as a shareholder and to be paid any accrued dividends.[5]

§ **2234. When Stockholder of Lessee Corporation Can Not Sue for Dividend.**— Two corporations agreed with one another for a lease of the property of the one to the other, the lessor guaranteeing a certain dividend, and agreeing to make certain quarterly payments. It was held that a stockholder of the lessee

[1] Southwestern &c. R. Co. *v.* Thomason, 40 Ga. 408; *post*, §§ 2425, 2567.

[2] *Ibid.*

[3] Scott *v.* Central R. Co., 52 Barb. (N. Y.) 45; *ante*, § 2229.

[4] Hughes *v.* Vermont Copper Mining Co., 72 N. Y. 207. Cases depending upon particular circumstances: Bates *v.* Androscoggin &c. R. Co., 49 Me. 491; State *v.* Baltimore &c. R. Co., 6 Gill (Md.), 363; Bank of Commerce *v.* Dalrymple, 16 Md. 17; Moss' Appeal, 43 Pa. St. 223; Soeding *v.* Bonner &c. Iron Co., 35 Mo. App. 349.

[5] *Post*, § 2427.

corporation could not, on behalf of himself and other stockholders, maintain an action against the lessor corporation to enforce the agreement and to compel the payment of his dividend.[1] The reason was that the promise was made to the lessee corporation, and not to its stockholders.[2]

[1] Harkness *v.* Manhattan R. Co., 54 N. Y. Super. 174.

[2] The court cited and relied on Wheat *v.* Rice, 97 N. Y. 296, where a promise to assume the debts of a copartnership was held not a promise to any one of its creditors.

CHAPTER XXXVI.

INTEREST-BEARING, PREFERRED AND GUARANTEED STOCK.

ARTICLE I. INTEREST-BEARING STOCK

§ 2236. Corporation can not Contract to Pay Interest on Its Shares. — The better view is that a corporation can not contract to pay interest or dividends on the shares of its capital stock in the excess of its earnings, unless expressly authorized to do so by statute.[1] The reason is that a corporation cannot, in the absence of legislative sanction, divide its capital stock among its shareholders. A railroad company can not, therefore, without special legislation, contract to pay *interest on stock* before the road is completed or any income received; and a contract to do so cannot be enforced against the capital of the company.[2]

[1] Pittsburg &c. R. Co. *v.* Allegheny County, 63 Pa. St. 126; Painsville &c. R. Co. *v.* King, 17 Oh. St. 534; Ohio College *v.* Rosenthal, 45 Oh. St. 183; *s. c.* 12 N. E. Rep. 665; Re Sharpe (1892), 1 Ch. 154; *ante*, §§ 1536, 1576; *post*, § 2244

[2] Painsville &c. R. Co. *v.* King, *supra*.

§ 2237. Nor Guarantee Dividends on Shares of Another Company. — For stronger reasons, a corporation can not, in the absence of express legislative authorization, guarantee dividends on the capital stock of another corporation at a certain rate per cent. per annum, and without reference to the question whether it should have any profits out of which to pay them; for such a guaranteed annual dividend is merely another form of a contract to pay interest on shares *of another company*.[1] Such a guaranty, it has been held, can not be enforced, although made to induce subscriptions to the capital stock of the company, and although made partly in consideration of necessary services tendered by the subscriber to the corporation.[2]

§ 2238. But may Guarantee "Interest Dividends" Payable out of Profits.— A railroad corporation has authority to stipulate that each stockholder shall be entitled to interest on sums paid on stock subscriptions while its road is in process of construction, till it is completed and goes into operation, payable whenever the surplus earnings shall enable it properly to do so. The reasoning is that such an arrangement for the payment of "interest dividends" is equitable and just, and such payment, made only out of the surplus earnings not needed for the payment of the debts of the corporation or for the prosecution of its business, does not interfere with the rights of creditors, nor contravene any principle of public policy.[3] What is known as "preferred" or "guaranteed" stock is usually stock in respect of which there is a guaranty by the corporation that the holder shall be entitled to dividends at a certain per cent. per annum in preference to other stock. Such a guaranty has been held to be nothing more than a pledge of the funds of the corporation which may be legally applicable to the payment of dividends,— that is a *pledge of its profits*, and it merely creates a *preference in the distribution of its profits* among its shareholders. Hence, if it appear in any case that no profits have been earned, the holders of the preferred stock can not maintain

1 Memphis Grain &c. Co. *v.* Memphis &c. R. Co., 85 Tenn. 703; *s. c.* 4 Am. St. Rep. 798; 5 S. W. Rep. 52.

2 *Ibid.*

3 Richardson *v.* Vermont &c. R. Co., 44 Vt. 613.

actions against the company to enforce payment of the guaranteed dividends.[1]

§ 2239. **"Interest Certificates" not Shares.** — "Interest certificates" issued by a corporation to its shareholders, such as those under consideration, are not shares of the stock of the corporation, and do not pass under the description of shares in a will. This may be illustrated by a well considered case where a testator bequeathed to legatees a specified number of shares of the stock of a corporation. After the execution of the will, and before the testator's death, the corporation issued to its stockholders certain "interest certificates," stated to be for moneys expended out of its earnings in improvements. By their terms, these certificates were made assignable, and payable, at the option of the company, out of future earnings, with dividends thereon, or convertible into stock. The testator received and retained these certificates on the shares held by him, and also the dividends declared thereon, and held the certificates at the time of his death. It was held that the legatees took the specified number of shares of stock as they were at the time of the testatator's death, and could claim no right to, or interest in the certificates. The reasoning of the court, in a lucid opinion by Folger, J., was that these certificates, whether considered as dividends or not, did not become attached to the shares of stock. If dividends they belonged to the stockholder owning the shares upon which they were paid ; paid, to be sure, as something growing out of his stock, but instantly, when paid, separable from and independent of it, as much so as though paid in money, and appearing in his assets as a deposit to his credit in his bank account. If not dividends, but an optional agreement to pay the amount expressed or to convert into other shares of stock, then by their terms they were transferable by the holder, and by their terms and by the necessary legal effect of them, an independent thing of value, not a part of the stock, nor in any way

[1] Taft *v.* Hartford &c. R. Co., 8 R. I. 310, 332; *s. c.* 5 Am. Rep. 575. A statute authorizing a railroad company to issue shares of stock to be applied to the payment of interest on installments paid in by subscribers to the stock, until an income should be realized from the road, was construed in Manice *v.* Hudson &c. R. Co., 3 Duer (N. Y.), 426.

attached thereto, or accompanying it. In either view, a person becoming a holder of the stock subsequent to the issue of the certificates to a prior holder of the stock, acquired no right or interest in them. Nor did the court see the force of an argument based on the fact that the certificates were payable, at the option of the company, out of future earnings; since they represented past earnings of the road used to increase its value, and since they were, by their terms, assignable.[1]

§ 2240. Protection of the Corporation in Case of the Loss of such a Certificate. — It has been held that a corporation which has issued negotiable certificates for an extra dividend, making them payable at a time fixed therein, or sooner at its option, and elects to redeem them sooner, cannot refuse to pay a stockholder the amount of a lost certificate. It may protect itself by exacting indemnity, as in case of lost commercial paper.[2]

§ 2241. An Illustrative Case where the Contract to Pay Interest on Share was Held Void. — A corporation, not for profit, for maintaining a dental college, issued to its subscribers certificates, marked shares $100 each, "stating that the holder was entitled to one share of the real property of the college, drawing an interest at six per cent.," mentioning no time for the payment. The entire property of the college consisted of real estate purchased for $12,000, the proceeds of 120 subscriptions. For forty years no interest had been paid. It was held that interest could not be recovered, because (1) there was no express promise, and no time of payment was mentioned; (2) its payment would be contrary to the purposes of the incorporation, and cause its dissolution; (3) a promise to pay interest out of capital is void; and (4) there was no allegation that its members intended its dissolution.[3]

[1] Brundage *v.* Brundage, 60 N. Y. 544; affg. *s. c.* 65 Barb. (N. Y.) 397; 1 Thomp. & C. (N. Y.) 82; distinguishing Clive *v.* Clive, Kay, 600, and Burroughs *v.* North Carolina R. Co., 67 N. C. 376; *s. c.* 12 Am. Rep. 611.

[2] Butler *v.* Glen Cove Starch Co., 18 Hun (N. Y.), 47. See *post*, §§ 2520, 2521.

[3] Ohio College *v.* Rosenthal, 45 Ohio St. 183; *s. c.* 12 N. E. Rep. 665.

Article II. Issuing Preferred Stock.

§ 2244. Power to Issue Preferred Stock as against the Dissent of Common Shareholders. — "Shares conferring on their holders preferential or additional rights not enjoyed by the holders of other shares are called *preference shares* or *preferred shares*. They can only be created when the authority to create them is given by statute or charter, or by agreement between all parties interested."[1] This principle is undoubtedly sound, and flows from another principle equally plain, which is thus expressed by the same learned writer: "Unless the contrary is declared by statute, charter, or express contract, all shareholders are entitled to equal rights; and no class is entitled to any preference or priority over any other. Nor can a majority of shareholders deprive a minority of this right of equality."[2] Interest-bearing stock, as we have seen,[3] stands on a different footing from preferred stock; and it may readily be concluded that the power in

[1] Lind. Comp. Law, 5th ed., p. 396.

[2] *Ibid.*; citing Hutton *v.* Scarborough Hotel Co., 2 Dr. & Sm. 514 and 521; and 9 Jur. (N. S.) 551; Ashbury *v.* Watson, 30 Ch. Div. 375. See also Guinness *v.* Land Corp. of Ireland, 22 *Id.* 349.

[3] *Ante*, § 2236, *et seq.*

a corporation to pay interest upon its shares, or to guarantee the payment of interest thereon, must be set forth in the express language of its governing statute or other governing instrument, and if not there found it does not exist. In other words, it does not exist as a power *implied* from general forms of expression. In this line of thought, it has been held that the power granted in the charter of a railway company to do all the lawful acts incident to its corporate existence, with "such additional powers as may be convenient for the due and successful execution of the powers granted," will not legalize a guaranty of a specific dividend on its stock, at a premium to induce a subscription, even though the guaranty be in part consideration of services rendered by the subscriber for the company.[1]

§ 2245. Power to Issue as against Unregistered Shareholders. — The rule of the preceding section extends so far that, although all the registered shareholders consent to the issue of preferred shares, their action will not be allowed so to operate as to affect the rights of any unregistered owners of the common stock. This is illustrated by a case where the corporation and all its registered stockholders signed an agreement whereby, in order to raise money to pay debts, 40 per cent. of the stock was surrendered and cancelled, and in place thereof new stock, entitled to a first lien upon the net profits for dividends of 10 per cent., was issued and sold. It was held that this action was not within the corporate powers of the company or stockholders, and therefore was not binding upon one who held stock under an unregistered assignment in blank as security for a debt; and upon a sale thereof, after default, the purchaser was entitled to a new certificate giving the same rights as the old.[2]

§ 2246. Whether Power to Borrow Includes Power to Issue Preferred Shares. — Corporations organized to carry on a business the prosecution of which may require money, have the

[1] Elevator Co. *v.* Memphis &c. R. Co., 85 Tenn. 703; *s. c.* 4 Am. St. Rep. 798; 5 S. W. Rep. 52.

[2] Campbell *v.* American Zylonite Co., 122 N. Y. 460, Vane, J., dissenting; *s. c.* 25 N. E. Rep. 853 (reversing 23 Jones & S. 562; 3 N. Y. Supp. 822.)

implied power to borrow money, and to issue for it any form of obligation or security that is not unlawful.[1] "It may borrow from the stockholders in it,[2] as well as from other parties; and it may determine aud agree to borrow from them only." [3] But the issue of what are ordinarily known as preferred shares, that is, of shares which enjoy a preference over the common shares in the payment of dividends, is not a borrowing; and the power to raise money in this way cannot be implied as a borrowing power. In so holding it was said by the New York Court of Appeals, speaking through Folger, J.: "To borrow is the reciprocal action with to lend; and to lend or to loan, say the dictionaries, is the parting with a thing of value to another for a time fixed, or indefinite, yet to have some time an ending, to be used or enjoyed by that other, the thing itself, or the equivalent of it, to be given back at the time fixed, or when lawfully asked for, with or without compensation for the use, as may be agreed upon. In this transaction with some stockholders, that corporation had not the right, nor was it under the liability to ever pay back the five dollars per share furnished by them to it; that was not named in the terms of the obligation given, nor was it contemplated in the negotiation and bargain. The stockholder had not by the scope of his bargain, nor by the terms of the written evidence of it, any right ever to ask for repayment of the money furnished by him. In short, there was not formed thereby the relation of debtor and creditor. The stockholder parted forever with the money furnished, inasmuch as the charter of the company is perpetual, and the company made a perpetual charge upon its net earnings. Though there was a compensation fixed for the use of the money, and though it was to take the form of a yearly payment, and at a rate the same as the then lawful rate of interest, yet we cannot conceive that the transaction was a loan and borrowing of money, with a compensation for the use of it." [4] On the other hand, the Supreme Court of Pennsylvania hold that the issuing of preferred stock is only a form of mortgaging the earnings of a corpora-

[1] *Post*, Ch. 125.

[2] Curtiss *v.* Leavitt, 15 N. Y. 9; Kent *v.* Quicksilver Mining Co., 78 N. Y. 159 177, per Folger, J.; *post*, § 4068.

[3] Kent *v.* Quicksilver Mining Co., *supra*.

[4] Kent *v.* Quicksilver Mining Co., 78 N. Y. 177, 178.

tion. It follows that a corporation may, if it has power to borrow money on bond and mortgage, as a mode of borrowing money, issue new shares and give to the holders of them a preference over the holders of its common stock.[1]

§ 2247. **Charter Amendment Conferring the Power not a Fundamental Alteration.**— In the same line of thought, and in manifest opposition to the New York view, it is held in Pennsylvania that an act of the legislature authorizing the issue of preferred stock, does not, when accepted by the corporation, constitute such an alteration of the charter as will release the subscribers to the common stock from their liability as stockholders:[2] the principle being that modifications and improvements in the charter useful to the public and beneficial to the company, and in accordance with what was the understanding of the subscribers as to the real object to be affected, do not impair the contract of subscription.[3] The same court holds that an act of the legislature authorizing the issue of preferred stock, if accepted by the stockholders, *empowers the* directors of the corporation to issue the same, although individual stockholders may oppose it.[4]

§ 2248. **Power May be Reserved in Articles of Association.** — There is no doubt that where the governing statute authorizes it (and probably where it does not forbid it), a corporation may assume this power, by a clause to that effect in its articles of association or other instrument of incorporation, so that a majority may order such shares to be issued contrary to the will of the minority.[5] A limited company in England,

[1] Westchester &c. R. Co. *v.* Jackson, 77 Pa. St. 321, 327.

[2] Everhart *v.* Phila. &c. R. Co., 28 Pa. St. 339, 353.

[3] *Ibid.* See on analogous theories Irvin *v.* Turnpike Co., 2 Penn. & W. (Pa.) 466; *s. c.* 23 Am. Dec. 53; Gray *v.* Monongahela Nav. Co., 2 Watts & S. (Pa.) 156; *s. c.* 37 Am. Dec. 500; Clark *v.* Monongahela Nav. Co., 10 Watts (Pa.) 364; Indiana &c. Turnpike Co. *v.* Phillips, 2 Penn. & W. (Pa.) 184; *ante*, § 1278, *et seq.*

[4] Curry *v.* Scott, 54 Pa. St. 270. These decisions are entitled to little respect. They were rendered at a time when all the institutions of Pennsylvania were notoriously subject to railroad manipulation. Compare McManus *v.* Philadelphia &c. R. Co., 58 Pa. St. 330.

[5] Re Bridgewater Nav. Co., 39 Ch. Div. 1; Re South Durham Brewery Co., 31 Ch. Div. 261; Harrison *v.* Mexican R. Co., L. R. 19, Eq. 358.

authorized by its articles to issue preferential shares to be offered to members in proportion to existing shares held, and to accept surrenders of shares upon terms to be agreed upon, may issue preferential shares, as *fully paid up*, to holders of ordinary shares, in consideration of the surrender of an equivalent amount of fully paid up ordinary shares, where the surrenders are *bona fide*, and not to enable the shareholder to escape liability.[1]

§ **2249. Or Assumed at the Outset in its By-Laws.** — There is a dictum by an eminent judge in an important case to the effect that a corporation created by a special charter may, by by-laws adopted in advance of its receiving subscriptions to its stock, divide its stock into classes, preferring one class over another. "We are not prepared to say," said Folger, J., "that at the first the corporation might not have lawfully divided the interest in its capital stock into shares arranged in classes, preferring one class to another in the right it should have in the profits of the business. The charter gave power to make such by-laws as it might deem proper, consistent with constitution and law; and to issue certificates of stock representing the value of the property. We know nothing in the constitution or the law that inhibits a corporation from beginning its corporate action by classifying the shares in its capital stock, with peculiar privileges to one share over another, and thus offering its stock to the public for subscriptions thereto. No rights are got until a subscription is made. Each subscriber would know for what class of stock he put down his name, and what right he got when he thus became a stockholder. There need be no deception or mistake; there would be no trenching upon rights previously acquired; no contract express or implied, would be broken or impaired."[2]

§ **2250. Can not Divide Its Shareholders into Two Classes after Subscriptions Made.** — But although a corporation may

[1] Eichbaum *v.* City of Chicago Grain Elevators (1891), 3 Ch. 459; Teasdale's case, L. R. 9, Ch. 54. Compare Trevor *v.* Whitworth, 12 App. Cas. 409.

[2] Kent *v.* Quicksilver Mining Co., 78 N. Y. 178, 179.

possibly do this by a by-law in the first instance and before any subscriptions have been taken, it clearly can not, after its shares have been distributed, divide its existing shareholders into two classes, giving to one class a preference over the other, without unanimous consent. When, therefore, it has at the outset enacted a by-law fixing the entire amount of its capital stock as ordinary or common stock, which is construed to consist of shares equal in value and right, and when the stock thus fixed has been distributed, — it cannot, by a subsequent by-law, provide that some of the shareholders may, within the time named, by paying to the company a certain sum (here $5) per share, be entitled to surrender their common shares and receive preference shares entitling them to an annual dividend of seven per cent. in preference before any dividend shall be declared on the common stock. The reason is that such an arrangement disturbs the vested rights of the common stockholders who do not assent to it. Said Folger, J., speaking for the court: "When that by-law was adopted, it was as much the law of the corporation as if its provisions had been a part of the charter.[1] So it is said in Grant on Corporations,[2] in a qualified way. Thereby, and by the certificate, as between it and every stockholder, the capital stock of the company was fixed in amount, in the number of shares into which it was divisible, and in the peculiar and relative value of each share. The by-law entered into the compact between the corporation and every taker of a share; it was in the nature of a contract between them. The holding and owning of a share gave a right which could not be divested without the assent of the holder and owner; or unless the power so to do had been reserved in some way.[3] Shares of stock are in the nature of *choses in action*, and give the holder a fixed right in the division of the profits or earnings of a company so long as it exists, and of its effects when it is dissolved. That right is as inviolable as is any right in property, and can no more be taken away or lessened, against the will of the owner than can any other right, unless power is reserved in the first instance, where it enters into the constitution of the right, or is

[1] Presbyterian Church *v.* City of New York, 5 Cow. (N. Y.) 538.

[2] Page 80.

[3] Mechanics Bank *v.* New York &c. R. Co., 13 N. Y. 599, 627.

properly derived afterwards from a superior law giver. The certificate of stock is the muniment of the stockholder's title, and evidence of his right. It expresses the contract between the corporation and his co-stockholders and himself; and that contract cannot, he being unwilling, be taken away from him or changed as to him without his prior dereliction, or under the conditions above stated. Now it is manifest that any action of a corporation which takes hold of the shares of its capital stock already sold and in the hands of lawful owners, and divides them into two classes — one of which is thereby given prior right to a receipt of a fixed sum from the earnings before the other may have any receipt therefrom, and is given an equal share afterwards with the other in what earnings may remain, — destroys the equality of the shares, takes away a right which originally existed in it, and materially varies the effect of the certificate of stock." [1]

§ 2251. Such Power Not Conferred by a Power to Alter By-Laws.— A power thus to create inequality among the shareholders against the will of the minority of them is not conferred by a power to make, repeal or alter by-laws,[2] since no corporation has power to establish by-laws which impair vested rights.[3] And this is so, although in the light of what has subsequently transpired, the agreement may appear to have been exceedingly unconscionable; for an unconscionable arrangement will not be disturbed where there has been a *ratification* of it with knowledge of all its bearings, if time has been had for consideration.[4]

§ 2252. Such a Change Not Valid as Against Unregistered Shareholders, though all Registered Shareholders Consent.— The principle being that the right of every shareholder to his proportionate share of the corporate profits is a vested right, and that, in the absence of some power to change the relative value of the shares, conferred by the governing statute or as-

[1] Kent *v.* Quicksilver Mining Co., 78 N. Y. 179–180.

[2] Kent *v.* Quicksilver Mining Co., 78 N. Y. 159, 182.

[3] *Ante,* § 1019; Gray *v.* Portland Bank, 3 Mass. 364; *s. c.* 3 Am. Dec. 156.

[4] Kent *v.* Quicksilver Mining Co., *supra.*

sumed by the members at the outset by some instrument binding upon them by way of contract or estoppel, no change can be made without the consent of all the shareholders,[1] — it has been held that an agreement signed by all the registered shareholders, whereby, in order to raise money to pay debts, forty per cent. of the stock is to be surrendered and sold, and new shares issued in lieu thereof, entitled to preferential dividends of ten per cent. per annum, is void even as against an unregistered pledgee of the common stock, and as against one who purchases the same from him after default in the payment of the debt for which they are pledged. The court, speaking through Follett, C. J., say: "Collective or corporate powers common to all stockholders may usually be exercised by a registered shareholder, though he has assigned all of his shares, and his action will bind his assignee holding under an unregistered transfer, and all others. These powers being conferred on corporations and their shareholders, purchasers are bound to know that they may be exercised by their assignors until the transfers are registered in their names. But the assignees of shares having possession of the certificates, though holding under unregistered transfers, are not bound by contracts between the registered shareholder, the corporation and all other shareholders which are not within the express or implied powers of corporations or of their shareholders. As between the assignor and the assignee, the unregistered assignment was not void under the 25th section of Ch. 40 of the laws of 1848.[2] It follows that the change in the relative value of the shares which this corporation and its registered shareholders sought to effect was not within the express or implied powers conferred upon the corporation or shareholders."[3]

§ 2253. Such Preferences Validated by Laches and Estoppel. — But even though the issuing of preferred shares is wrongful to the common shareholders and illegal, so that such action would be enjoined at the suit of a minority of the common shareholders if they should bring their action in time, — yet

[1] *Ante*, § 2094.

[2] Citing Johnson *v.* Underhill, 52 N. Y. 203.

[3] Campbell *v.* American Zylonite Co., 122 N. Y. 455, 460; *s. c.* 25 N. E. Rep. 853; 34 N. Y. St. Rep. 38; 11 L. R. A. 596.

where they acquiesce in such an arrangement for a long period of time, during which the rights of innocent members of the public have supervened to such an extent that great wrong would be done to them by declaring the preference shares illegal, — an action brought by shareholders for this purpose will be repelled, — as, under a collection of stated circumstances, where there has been a delay of four years.[1] Thus, where one of the promoters of a manufacturing corporation, who afterwards became its manager, voluntarily subscribed and paid for some of its preferred stock, for the purpose of promoting the scheme, which stock he held for twenty-eight months, the corporation performing all the terms and conditions of the subscription on its part, he could not, the corporation having become insolvent, rescind his subscription and recover the money paid for the shares on the ground that neither the governing statute nor the articles of association authorized the issue of such shares.[2] So, where the directors of a hotel company, in pursuance of the request of three-fourths of the shareholders and in opposition to a directory statute, made an unauthorized issue of preferred stock for the purpose of securing money to pay the legitimate debts of the company, and for other corporate purposes, which stock was subsequently redeemed by the issue of *mortgage bonds*, — it was held that holders of the common stock who knew of this unauthorized issue of preferred stock but did not take prompt action to disaffirm the same, were not entitled to relief in equity against proceedings to foreclose the mortgage. The court laid stress on the fact that no principle of public policy was involved, that no wrong had been done of a public nature, and that the corporation had had the full benefit of a performance of the contract on the part of the mortgagee.[3] So, it has been held that an acquiescence of

[1] Kent *v.* Quicksilver Mining Co., 78 N. Y. 159; affg. *s. c.* 12 Hun, 53. See to the general principle, Veeder *v.* Mudgett, 95 N. Y. 310; Chubb *v.* Upton, 95 U. S. 665. Compare Sheldon &c. Co. *v.* Eickemeyer Co., 90 N. Y. 613; Aspinwall *v.* Sacchi, 57 N. Y. 331; Eaton *v.* Aspinwall, 19 N. Y. 119; *Contra,* American Tube Works *v.* Boston Machine Co., 139 Mass. 5; National Bank *v.* Drake, 29 Kan. 330.

[2] Bard *v.* Banigan, 39 Fed. Rep. 13; *s. c.* 26 Am. & Eng. Corp. Cas. 155; 6 Rail. & Corp. L. J. 170; *s. c.* affirmed, *sub nom.* Banigan *v.* Bard, 134 U. S. 291; *s. c.* 10 Sup. Ct. Rep. 565.

[3] Hill *v.* Cincinnati Hotel Co. (Super. Ct. Cin.), 25 Ohio L. J. 425.

the common stockholders, for a period of nearly *four years*, in a resolution of the directors for the issue of preferred stock, will preclude them from setting aside the issue, where the money realized therefrom has been used by the corporation, and where the public have been allowed to deal in the preferred stock under the belief, engendered by silence, that no objection would be made to its validity.[1] On the contrary, where "*special stock*," described in a preceding chapter,[2] had been illegally issued under a statute of Massachusetts to a creditor of the corporation who subsequently received dividends thereon; and the corporation, at two subsequent meetings, had attempted, but without success, to cure the defect, and to make a valid issue of stock instead of it; and, twenty-seven months after the illegal issue, and two months after the last attempt to cure the defect, and shortly before the corporation became insolvent, the creditor gave notice that he rescinded the contract, and tendered back the dividends received, — it was held that his election to rescind had been exercised within a reasonable time, and that he could prove the amount of his debt against the estate of the insolvent corporation.[3] In this last case the creditor made the election to repudiate his stock, and offered to return it, before the corporation had been adjudicated insolvent. In a subsequent case, the same court, extending the doctrine, held that a holder of such stock which has been illegally issued, may prove against the estate of the corporation in insolvency, the amount paid by him for the stock, deducting any dividends received, although he did not rescind the contract before the insolvency. In the view of the court, there was no occasion for him to return his certificates, since they had become valueless, nor the dividends which he had received, because they were less than the sum which he was entitled to receive, the stock being and remaining invalid.[4] These cases proceed upon the view that there can be no such thing as a *stockholder by estoppel*, except in cases where there can be a *legal issue* of the particular stock; and this is the strictly logical view, as has been often held in respect of the

[1] Hoyt *v.* Quicksilver Mining Co., 17 Hun. (N. Y.), 169. Gilbert, J., dissented in a forcible opinion.

[2] *Ante*, § 2042.

[3] American Tube Works *v.* Boston Machine Co., 139 Mass. 5.

[4] Reed *v.* Boston Machine Co., 141 Mass. 454; *s. c.* 5 N. E. Rep. 852.

fraudulent over-issues of corporate shares.[1] But it does not follow that, in every case, the person who has participated in the illegal act, by receiving the illegal shares, will stand in a position so favorable that he will have the right to have the contract undone for his benefit, after insolvency and at the expense of other creditors, or that he will have the right to maintain an action for damages against the corporation before insolvency to recover what he has paid for the illegal shares. It is to be noticed that a distinguished Federal judge, in taking the contrary view of this question in a case already cited, found himself "not favorably impressed" with the doctrine of these Massachusetts cases;[2] and that the Supreme Court of the United States, in affirming this last named case, in an opinion in which the reasoning of the judge who sat in the circuit court is quoted and adopted, has placed itself in distinct opposition to the Massachusetts doctrine.[3]

§ 2254. **Doctrine that Persons Accepting Preferred Stock Estopped from Disputing its Validity.** — It must be obvious, on a little reflection, that the doctrine of the Massachusetts cases, that a person can never become a *shareholder by estoppel* so far as the rights of creditors are concerned, unless the corporation had the legal power to issue the shares, cannot be asserted as an universal principle. The doctrine of estoppel *in pais*, as is well known, rests upon the idea that a party, by adopting a course of action which influences the conduct of others may put himself in a position where he will not be allowed to disclose the real truth. Such being the basis of the doctrine, it cannot, except in cases rising to the grade of questions of public policy, make much difference what that truth is. This principle of estoppel, in its every day-application, extends much farther than it is required to extend it, in order to prevent the holder of illegal corporate shares from repudiating the relation after the rights of creditors have supervened. We refer to the numerous and constantly recurring cases where a person who enters into a contract with another contracting party, by a name

[1] *Ante*, § 1493.

[2] Bard *v.* Banigan, 39 Fed. Rep., at p. 17, per Shipman, J.

[3] Banigan *v.* Bard, 134 U. S. 291; *s. c.* 10 Sup. Ct. Rep. 565.

or by language which admits that the other party is a corporation, thereby becomes estopped, in an action upon the contract, to deny that it is a corporation.[1] Stated in another way, this principle is so broad that a corporation itself may be created by estoppel for the purposes of a particular case, where no corporation exists in fact or in law. Upon these analogies there seems no insuperable difficulty in adopting the view of the Supreme Court of the United States, in opposition to that of the Supreme Judicial Court of Massachusetts, and in concluding that where persons accept preferred stock which has been illegally issued and receive interest upon it for several years, they and their assigns thereby become estopped from questioning the power of the corporation to issue it.[2]

§ 2255. Stockholder Proceeding in Time may Rescind.— But, on either theory, one who agrees to take preferred shares may evidently rescind on discovering that the issue will be illegal, if he proceeds in time. Thus, where the corporation borrowed money of one who at the time erroneously supposed that it had power to issue preferred shares, promising to issue such shares to him in payment of the loan,— it was held that he might, on discovering that it had no such power, maintain an action to recover his money back, and that it was no defense that, pending the action, a statute was enacted under which preferred stock was issued and offered to plaintiff.[3].

§ 2256. Constitutional and Statutory Provisions. — By the constitution of Alabama it is provided: "No corporation shall issue preferred stock without the consent of the owners of two-thirds of the stock of said corporation.[4] By the constitution of Missouri, "No corporation shall issue preferred stock without the consent of *all* the stockholders."[5] Statutory grants of this power,[6] and statutory prohibitions of it[7] exist; but it has been found impracticable to collect them. A statutory authority to issue preferred stock does not, it has

[1] *Ante*, § 495, *et seq.*; § 1846, *et seq.*; *post*, Ch. 184, *et seq.*

[2] Branch *v.* Jesup, 106 U. S. 468.

[3] Anthony *v.* Household Sewing Mach. Co., 16 R. I. 571; *s. c.* 18 Atl. Rep. 176; 5 L. R. A. 575.

[4] Ala. Const. of 1875, art. 13, § 9.

[5] Mo. Const. of 1875, art. 12, § 10.

[6] Ala. Acts, 1883–89, No. 98, p. 86.

[7] Gen. Laws Minn. 1887, c. 49, p. 104.

been held, include a grant of power to issue *common* stock.[1] A *contract* by a corporation to repay a loan in preferred stock which it had no authority to issue, being a nullity, is not *renewed* by a subsequent act authorizing it to issue preferred stock, but which does not empower it to renew that contract.[2]

§ 2257. Privilege of Taking in Exchange for Common Stock when Exercised. — In schemes by which preferred stock is issued in exchange for common stock, the privilege of making the exchange is usually accorded to the members to be exercised within a time fixed by the resolution; and where the resolution does not fix the time, it must be exercised within a *reasonable time*. It has been held that a tender of common stock and the additional sum required for an exchange, made *thirty-three years* after the privilege was conferred, is not made within a reasonable time.[3]

§ 2258. Formalities in the Mode of Issuing. — Where, in Massachusetts, the statute defines the mode in which "special stock" may be issued, a departure from the statutory requirements invalidates the issue; as, for instance, where the call is to consider whether *preferred stock* shall be issued, and, under such call, a vote to issue special stock is had, or where the record fails to show the assent of the required number of stockholders. Nor in Massachusetts, contrary to the general rule[4] does the doctrine of estoppel apply to the case of one who has taken stock of an illegal issue.[5]

1 Covington &c. Bridge Co. *v.* Sargent, 1 Cinc. (Ohio) 354.

2 Anthony *v.* Household Sewing Mach. Co., 16 R. I. 571; *s. c.* 5 L. R. A. 575; 18 Atl. Rep. 176. There is a useful note on the subject of preferred stock in 19 Am. & Eng. Corp. Cas. 468. That a note given in payment of a subscription for preferred stock is valid, etc., see Magee *v.* Badger, 30 Barb. (N. Y.) 246.

3 Holland *v.* Cheshire R. Co., 151 Mass. 231; *s. c.* 24 N. E. Rep. 206. In the same case it was held that the appointment by the corporation of a committee, *twenty years* after a vote authorizing stockholders to exchange common for preferred stock, to investigate the claims of holders of common stock, with authority to settle the same by purchase or otherwise, and a purchase by the committee of common stock, giving in exchange therefor shares of preferred stock previously bought in by the company and held as part of the assets, — did not constitute an exchange of stock under the original arangement. *Ibid.*

4 *Ante*, § 2253.

5 American Tube Works *v.* Boston Machine Co., 139 Mass. 5.

Article III. Rights of Preferred Shareholders.

§ 2262. Right to Preferential Dividends Depends upon Contract. — It is next proposed to consider the rights of preferred shareholders; and the chief question with which we are concerned consists of their right to *dividends.* It must be borne in mind that the right to dividends on preferred stock springs out of *contract,* from which it follows that the right to such dividends depends upon different principles from those relating to dividends of common stock. Controversies in respect

to dividends on preferred stock must be determined in each case by the terms of the contract creating the preference.

§ 2263. Such a Contract may Consist of a By-Law. — A *by-law* providing for the payment of dividends on the preferred stock of a company establishes a *contract* between the company and its preferred stockholders.[1] And it may be added, with the most entire confidence, that whether the stock is issued in pursuance of a by-law, or of a resolution of the board of directors, or of a resolution passed at a general meeting of stockholders (always assuming that the act is valid), the person who receives the preferred shares in pursuance of it, acquires a right resting in contract and enforceable on the theory of contract. This is assumed in all the cases on the subject and is nowhere disputed.

§ 2264. Preferred Stock Gives a Right to Interest Chargeable Upon Profits. — The view of some of the English courts that a preferred and guaranteed dividend authorized by an act of parliament is substantially *interest, chargeable exclusively upon profits*,[2] has been adopted in this country, and the conclusion thus expressed has been reached: "The guarantee of a dividend by a railway company is construed by the courts * * * to mean nothing more than a pledge of the funds legally applicable to the purposes of a dividend; that, in short, it is a *dividend*, and not a *debt*, which is thus preferred and guaranteed." [3]

§ 2265. Entitles the Holders to Dividends only in Case They are Earned. —The ordinary species of preferred stock entitles the holders to a dividend of a certain per centum out of the profits of each particular year, in preference to any dividends on the common stock. It amounts merely to an engagement to *divide earnings* among the preferred stockholders in preference

[1] Belfast &c. R. Co. *v.* Belfast, 77 Me. 445; Hazeltine *v.* Belfast &c. R. Co., 79 Me. 411; *s. c.* 1 Am. St. Rep. 330.

[2] Henry *v.* Great Northern R. Co., 3 Jur. (N. S.), part I, 1133; *s. c.* 1 De Gex & J. 606. See also Crawford *v.* Northeastern R. Co., 3 Jur. (N. S.), part I, p. 1093; Matthews *v.* Great Northern R. Co., 5 Jur. (N. S.), part I, p. 284.

[3] Taft *v.* Hartford &c. R. Co., 8 R. I. 310; *s. c.* 5 Am. Rep. 575.

to those who are not preferred. If there are no earnings in a particular year, they get no dividend in that year. Whether there are earnings in a particular year, which can be divided among the preferred stockholders, is a matter for the directors to determine in the first instance in the exercise of a sound and honest business discretion, and subject to the control of the courts in case their discretion is abused, as hereafter shown.[1] Such a claim makes the holder of the share certificate a stockholder, and not a creditor.[2] If a dividend were *guaranteed*, or if the promise were to pay *interest* on the shares absolutely and in any event, he would, to that extent at least, be a *creditor*. Where the corporation guarantees (as is sometimes the case) not only interest on the stock, but also agrees to receive back or otherwise liquidate the principal of the shares at par, at a date named, then the certificate becomes substantially an interest-bearing bond of the corporation, and the holder to the fullest extent a creditor, although he may *also* have rights pertaining to a shareholder, such as the right to *vote* at corporate meetings. It has been pointed out that under some schemes, what has been called "preferred stock" is really an interest-bearing debenture of the corporation, which creates the relation of debtor and creditor between the corporation and the so-called shareholder.[3] When, therefore, no profits have been earned out of which a preferred dividend can be paid, the holder of preferred shares on which a dividend is guaranteed at a certain rate per annum "before any dividends shall be paid on other stock of said company," cannot maintain an action of assumpsit for the recovery of the annual dividend thus guaranteed.[4]

[1] New York &c. R. Co. *v.* Nickals, 119 U. S. 296; *s. c.* 7 Sup. Ct. Rep. 209.

[2] Under an act empowering certain counties to subscribe for preferred stock of a certain railroad, to bear seven per cent. interest, it was held that a county was not to be a creditor, but a stockholder, and that their stock was to be preferred over the common stock by being entitled to seven per cent. interest out of the dividends in advance of the others. An expression in the certificate "prior and in preference to any dividend upon the capital stock of the company" was objectionable as implying that the county was not a stockholder. State *v.* Cheraw &c. R. Co., 16 S. C. 524.

[3] Such was the case in West Chester &c. R. Co. *v.* Jackson, 77 Pa. St. 321; in Burt *v.* Rattle, 31 Oh. St. 116; and in Williams *v.* Parker, 136 Mass. 204.

[4] Taft *v.* Hartford &c. R. Co., 8 R. I. 310; *s. c.* 5 Am. Rep. 575.

§ **2266. Right to Dividends Not Absolute, but Subject to Just Discretion of Directors.**— Under such a scheme as that named in the preceding section, the right of the holders of preferred shares is not an absolute right to a dividend in any event, but it is a qualified right to a dividend, to the extent named *in case there are profits which can appropriately be divided.* It is not enough that there may be net earnings; because the corporation may, from its nature, have public duties to perform, as in the case of a railroad company, whose duties require it to expend its net earnings in keeping up its properties so that it can serve the public severally and individually. "A different view," said the Supreme Court of the United States, speaking through Mr. Justice Harlan, "would lead to results which sound policy would seem to forbid, and which, therefore, it is not to be supposed were contemplated by the parties. For, if preferred stockholders become entitled to dividends upon a mere ascertainment of profits for a particular year, the duty of the company to maintain its track and cars in such condition as to accommodate the public and provide for the safe transportation of passengers and freight would be subordinate to their right to payment out of the funds remaining on hand after meeting current expenses and fixed charges."[1] And whether there are net earnings which can properly be distributed as a dividend on preferred shares must, in the first instance, be left to the decision of the directors, subject, of course, to judicial superintendence where the evidence shows that there are profits which can appropriately be so applied. In other words, to quote again from the language of the court in the same case, the preferred shareholders "are not entitled, of right, to dividends, payable out of the net profits accruing in any particular year, unless the directors of the company formally declare, or ought to declare, a dividend payable out of such profits; and whether a dividend should be declared in any year is a matter belonging in the first instance to the directors to determine, with reference to the condition of the company's property and affairs as a whole."[2]

§ **2267. Illustration.**— This is well illustrated by a case in the Supreme Court of the United States, where it appeared that pending

[1] New York &c. R. Co. *v.* Nickals, 119 U. S. 296, 306.

[2] *Ibid.* 307.

an action to foreclose mortgages upon the property of a railway company, an agreement was entered into, by holders of common and preferred shares of its stock and its creditors, for co-operation in the foreclosure and sale under one of the mortgages, the purchase of the property and franchises, and the organization of a new corporation to take and hold them, by one article of which it was agreed that preferred stock should be issued to an amount equal to the preferred stock of the company then outstanding, "entitling the holders to non-cumulative dividends, at the rate of 6 per cent. per annum, in preference to the payment of any dividend on the common stock, but dependent on the profit of each particular year, as declared by the board of directors." The agreement was carried out, its provisions being set out in the articles of association of the new company, and preferred stock was issued by it, as agreed. Subsequently the directors made a report of the operations of the new company for a particular year, showing a net profit of a large amount which had been applied to improvements of the property of the company. The court held that a suit by holders of preferred shares to compel the company to declare and pay a dividend to them out of the profits of that year could not be maintained. The agreement was not intended to confer upon preferred shareholders an absolute right to a dividend in any particular year, dependent alone on the fact, or the official ascertainment of the fact, that there were net profits in that year, unless the directors should formally declare or ought to declare a dividend payable out of such profits, and whether a dividend should be declared in any year was matter belonging, in the first instance, to the directors to determine, with reference to the condition of the company's property and affairs as whole.[1]

§ 2268. What are "Net Earnings" to be Appropriated in Dividends on Preferred Shares. — This question has been answered thus by Sir George Jessel, M. R.: "That means this, that the preferred shareholders only take a dividend if there are profits of the year sufficient to pay their dividend. * * * They are co-adventurers for each particular year, and can only look to the profits of that year. If they are lost for that year, they are lost forever. Profits for the year mean the surplus receipts, after paying the expenses and restoring the capital to the position it was in on the first day of January of that year."[2] The same view is thus expressed by a modern writer of reputa-

[1] New York &c. R. Co. *v.* Nickals, 119 U. S. 296.

[2] Dent *v.* London Tramway Co., L. R. 16 Ch. 344.

tion. "The directors of a corporation have a discretionary power to withhold profits from the holders of common shares in order to accumulate a surplus, etc.; but it is the duty of the directors to pay the preferred shareholders their promised or guaranteed dividends, whenever the company has acquired funds which may rightfully be used for the payment of dividends. This rule applies with peculiar strictness where the preferred holders are entitled to receive their dividends annually out of profits earned during the current year only, and a deficit in any year does not become payable out of subsequent profits."[1] Similarly, the following definition by Mr. Justice Blatchford has been often quoted: "Net earnings are, properly, the gross receipts, less the expenses of operating the road to earn such receipts. Interest on debts is paid out of what thus remains, that is, out of net earnings. Many other liabilities are paid out of net earnings. When all liabilities are paid, either out of the gross receipts or out of the net earnings, the remainder is the profit of the shareholders, to go towards dividends, which in that way are paid out of the net earnings."[2] "Net earnings are what is left after paying current expenses and interest on debt and everything else which the stockholders, preferred and common, as a body corporate, are liable to pay."[3]

§ 2269. Interpretation: Dividends on Preferred Stock Not Payable out of Earnings of Subsequent Years. — The following by-law has been the subject of judicial interpretation: "Dividends on the preferred stock shall first be made semi-annually from the net earnings of the road, not exceeding six per centum per annum, after which dividend, if there shall remain a surplus, a dividend shall be made on the non-preferred stock up to a like per cent. per annum; and should a

[1] Mor. Corp. 2d ed. § 459.

[2] St. John *v.* Erie R. Co., 10 Blatchf. (U. S.) 271, 279; *s. c.* affd, 22 Wall. 136. In Elkins *v.* Camden &c. R. Co., 36 N. J. Eq. 233, 239, it is said in discussing this question that "rights are to be governed and regulated each year by the peculiar condition of the corporation at the close of the year." This is in conformity with the definition of profits as given in People *v.* Supervisors, 4 Hill (N. Y.) 20, by Bronson, J.: "Profits generally mean the gain which comes in or is received from any business or investment where both receipts and payments are to be taken into account." See also the reasoning in Belfast &c. R. Co. *v.* Belfast, 77 Me. 445, 452; New York &c. R. Co. *v.* Nickals, 119 U. S. 296.

[3] Warren *v.* King, 108 U. S. 389, 398.

surplus then remain of net earnings, after both of said dividends, in any one year, the same shall be divided pro rata on all the stock." The meaning of this by-law is that the preferred stock is, so to speak, "*non-cumulative*," which is understood to mean that the arrearages of one year cannot be paid out of the earnings of a subsequent year.[1]

§ 2270. **Earnings not Withheld from Preferred Stockholders in Order to Accumulate for the Liquidation of Funded Debts Maturing in the Future.**—But if a corporation has a funded interest-bearing debt which represents so much borrowed capital, and is able to maintain its plant in a suitable condition for the conduct of its business and to pay the interest on such funded debt, the directors will ordinarily not be justified in allowing profits to accumulate in a reserve fund for the purpose of liquidating the funded debt when it matures, to the exclusion of the right of preferred stockholders to their dividends. Such a rule, it has been pointed out, would in the case of many, if not most of the American railways, result in withholding the dividends from preferred stockholders indefinitely. The hardship is especially apparent when the rule is recollected[2] that where the dividends for a particular year are passed because there are no net earnings to divide, the right to that dividend is lost forever. The justice of the rule becomes more apparent when the well-known practice of railway companies and other corporations of paying their funded debt at maturity by refunding or issuing new bonds secured by a new mortgage, is considered. The question really does not need elaboration; but the reasons in support of this view have been forcibly stated by Mr. Chief Justice Peters in a recent well-considered case in Maine.[3] The decision involved the interpretation of a by-law in the nature of a contract between the company and its shareholders which began with the recital that "dividends on the preferred stock shall first be made semi-annually from the net earnings of the road," etc. Of course, the real question for decision was whether money accumulated and not necessary for the payment of any current expenses is to be deemed net earnings where there is a bonded

[1] Belfast &c. R. Co. *v.* Belfast, 77 Me. 445, 449; Hazeltine *v.* Belfast &c. R. Co., 79 Me. 411; *s. c.* 1 Am. St. Rep. 330.

[2] *Ante*, §§ 2266, 2268.

[3] Hazeltine *v.* Belfast &c. R. Co., 79 Me. 411; *s. c.* 1 Am. St. Rep. 330.

debt maturing in the near future, which debt is capable of being renewed, the security being ample, as was the fact in the particular case. The learned chief justice said: "The promise of the company was, that dividends semi-annually from net earnings 'shall be made.' But when the present mortgage debt of one hundred and fifty thousand dollars was established, it was to be paid in twenty years, and shall it not be paid at the end of that time, asks counsel? It may have been supposed that twenty years would be long enough for the debt to run without a renewal. But if it was even supposed that the debt could be conveniently paid at maturity without renewal, was it not calculated by the parties that dividends would be, in the meantime, distributed to the preferred stockholders? The result only proves a miscalculation by the company of its ability to literally perform its obligations. Is it an excuse for not declaring dividends out of net earnings, provided there are net earnings, merely that a company cannot pay an entire bonded debt at maturity without creating a new debt or borrowing again? Is it not reasonable to require the company to keep all its obligations, when they can easily do so? If the company had no means or credit which would enable them to place a new obligation on the market there would be force in the position. But no such inability is or possibly can be pretended. Can it be said that a railroad company makes no net profits in a year in which it gains thirty-six thousand dollars and has only nine thousand dollars to pay out, because it owes one hundred and fifty thousand dollars, payable in four years, abundantly secured upon its property, when the company has a perfect credit and abundant means to enable it to replace the old with a new loan on advantageous terms? Does a merchant who carries on business partly on borrowed capital, earn no profits in a year at the end of which, besides retaining his capital he has received twenty-seven thousand dollars more than all he has paid out, simply because he owes a debt for his borrowed capital which he has abundant ability to pay, but not without further borrowing? * * * There is hardly a railroad company in the world that has not a funded debt. Such a rule would work an injustice amounting to cruelty in many cases. Section 100, Chapter 42 of the Revised Statutes provides that savings banks may invest their

deposits in the stocks of any dividend-paying railroad in New England. How would the rule contended for work with savings bank deposits invested in Maine Central railroad stock, a company having three million six hundred thousand dollars stock and eleven million dollars indebtedness; or in the Boston and Maine, with a debt of seven million dollars; or in the Boston and Albany, with a debt of ten million dollars; or, if we look out of New England, in the Chicago, Burlington aud Quincy Railroad Company, one of the most reputable companies in our country, having more than eighty million dollars of funded indebtedness? What would annuities and life estates be practically worth to the holders of them in railroad companies, under a rule which allowed no dividends until all debts are paid? The history of railroad enterprises teaches us that the old liabilities of companies are well-nigh habitually paid by the creation of new ones, the general design being to lessen the liabilities, which are represented in the construction, by gradual processes."[1]

§ 2271. Right of the Preferred Stockholders to Participate with the Common Stockholders in any Surplus after Receiving their Preferred Dividend. — In a case involving this inquiry certificates of preferred stock recited that "the holder thereof is entitled to receive all the net earnings of said company which may be divided pursuant to said indenture in each year up to $7 per share, and to share in any surplus beyond $7 a share which may be divided upon the common stock." The indenture recited that "the holders of preferred stock shall be entitled to a dividend of seven per cent. before any dividend shall be declared upon other unpreferred stock, and to an equal dividend with said other shares in the net earnings of said corporation beyond said seven per cent. The preferred stock was issued by the company to its bondholders in lieu of redeeming the bonds in cash, and is thus described in the plan which was submitted to the bondholders to be signed by them at the time: "The preferred stock to be seven per cent. and not cumulative, but to share with the common stock any surplus which may be earned over and above seven per cent. upon both in any one year." It was held that, when the preferred stock has, in any one year, received its $7 per share, the common stock is entitled to receive $7 per share, if so much shall have been earned;

[1] *Ibid.* 421, 423, 424.

and that, if there be any surplus beyond this, the two kinds of stock shall share it equally.[1]

§ 2272. Circumstances under which Dividend on Preferred Stock may be Paid, although Capital Impaired. — In a case in Connecticut it appeared that a railroad company, in order to pay a large floating indebtedness, issued under legislative authority and sold for cash nineteen thousand shares of preferred stock, dividends on which to the amount of seven per cent. annually were to be paid from the net earnings of the company before any dividends on the common stock, — the seven per cent. or any part of it, when not paid by dividends, to accumulate. A general statute provided that no corporation should declare any dividend while its capital was impaired. There had been a large impairment of its capital prior to the issuing of the new stock. It was held that a dividend could be made on the preferred stock out of the net earnings of the road since the issuing of the same, without regard to the prior deficiency.[2]

§ 2273. Right to Pass the Dividend in Case of Changes of Ownership. — A supplement to the charter of a corporation authorized the issue of preferred stock, and provided "that, when so issued, the holders thereof, respectively, should be entitled to receive dividends on the same, not to exceed seven per cent. *per annum*, before any dividend should be set apart or paid on the other and ordinary stock of the company." It was held that holders of preferred stock were entitled to such dividends, up to seven per cent., as the profits of a particular year would yield, before any dividends were paid to the common stockholders, although the deficiency of profits in one year was not to be made up in another year; and that, when a holder of preferred stock failed to claim his rights in certain years, a subsequent owner thereof could claim re-imbursement.[3]

§ 2274. Effect of a Guaranty of Dividends: Whether Absolute or Conditioned on their being Net Earnings. — There is a difference of opinion upon the question whether a contract by which the shareholder becomes entitled to a dividend of a

[1] Bailey *v.* Hannibal &c. R. Co., 1 Dill. (U. S.) 174.

[2] Cotting *v.* New York &c. R. Co., 54 Conn. 156.

[3] Elkins *v.* Camden &c. R. Co., 36 N. J. Eq. 233.

certain per cent. each year, or by which the company also *guarantees* the dividend, creates an absolute obligation on the part of the corporation to pay interest on the shares, or only an obligation to pay a preferred dividend in case there are profits which can be divided. There would seem to be no room for doubt on the question; and yet the courts have doubted upon it, and have, the author thinks, gone wrong in deciding it. If the shares are entitled, we will say, to a preferred dividend of seven per cent., then the corporation must pay that dividend if there are profits which can be properly so applied, and to create this obligation the additional guaranty is not necessary. The rule of interpretation which makes the guaranty a mere guaranty of dividends in case there are profits out of which dividends can be declared, gives no effect whatever to that clause of the contract, and violates the rule that an instrument must be so interpreted, if possible, to give effect to all its parts. The additional guaranty can only mean that the company undertakes that the dividend shall be payable in any event, — in other words, it converts the certificate into an interest-bearing debenture. Where, in addition to the guaranty of interest at the rate named, the stock is payable *in full* on a dissolution of the corporation next after the payment of debts, there is no room for any hesitation in holding that the guaranty of interest is absolute and wholly independent of the question whether there are profits in any year whatever on which a dividend could be properly declared;[1] for here the share certificate is in the nature of an interest-bearing debenture.

§ **2275. Doctrine that Such a Guaranty is a Guaranty only in Case there are Profits.** — We must, however, take the decisions as we find them. There are holdings to the effect that a general guaranty of dividends by a railroad company on its preferred stock is not a guaranty of payment in any event, but only in the event that the dividends are earned.[2] It has also been held that the holders of preferred stock or preference shares of a corporation, are entitled to dividends when there are profits out of which dividends may be declared, and not other-

[1] Williams *v.* Parker, 136 Mass. 204.

[2] Miller *v.* Ratterman, 47 Ohio St. 141; *s. c.* 23 Ohio L. J. 416.

wise, although the resolution of the directors under which the stock is issued provides that "a semi-annual dividend of five per cent., payable in each year, shall be *guaranteed* by the company," and although the certificates of stock contain the recital "five per cent. semi-annual dividend *guaranteed*."[1] This conclusion is enforced by Mr. Justice Cooley in a train of specious reasoning, proceeding upon the view that the conclusion which would make such stock a debt and which would make the semi-annual guaranteed dividend merely interest, would place the preferred in antagonism to the general shareholder, and would thereby produce inharmony in the management of the corporation; since preferred shareholders would be interested in keeping it alive as long as they could sap its capital by the collection of the semi-annual dividends, while in case of its becoming a failing concern, the general shareholders would be interested in winding it up and distributing its capital among all the shareholders. "A contract," concluded the learned judge, "the necessary construction of which would be that on which the plaintiff relies, and which would lead or tend to the consequences pointed out, — which would require dividends when honesty and good faith to the public would forbid, and public opinion condemn them; which would antagonize the positions of different classes of men engaged in the same joint undertaking and preclude harmony of action and union of effort, precisely under those circumstances when harmony and union would be most essential; under which the corporation making it must almost inevitably be destroyed unless it should enjoy continuous prosperity; and which, under some circumstances, would make one class of persons having a voice in the control and management of the corporation interested in so controlling its means as to keep them as long as possible in an unproductive condition, until by a slow process they can absorb them to the prejudice of their associates, — must necessarily be opposed to public policy and void. And a contract which will bear any other reasonable construction could not, consistently with the rules of law, and with regard to what must be deemed the intent of the parties, that their contract should be just, reasonable and beneficial, have this construction put upon it."[2]

[1] Lockhart *v.* Van Alstyne, 31 Mich. 76; *s. c.* 19 Am. Rep. 156.

[2] *Ibid.*, p. 84.

§ 2276. Such a Guaranty may Make the Right to Dividends Cumulative. — Such a guaranty may, however, have the possible effect of making the right to the dividends *cumulative*, — that is, of making the profits of one year make up the deficiencies of the preceding years. At least one holding in an intermediate appellate court is found where the certificates stated that the stock was "entitled to dividends at the rate of 10 per cent. per annum, payable semi-annually, in New York, on the first days of June and December, in each year, out of the net earnings of said company; and the payment of dividends as aforesaid is hereby guaranteed." Here it was held that the holders of the stock were entitled to the guaranteed amount of dividends out of the net earnings whenever made, and were not restricted to the earnings of any year for the payment of dividends falling due that year.[1]

§ 2277. Whether a Preferential Certificate is of Stock or of Indebtedness. — Whether the scheme and the certificate issued in pursuance of it creates stock in the corporation or an indebtedness of the corporation to the scripholder must depend on the terms of the authorizing statute, of the resolution under which the certificates are issued, and of the certificates themselves. It is ruled in Ohio that where a resolution adopted by stockholders of a railroad company, authorizing the issue of preferred stock, recites that it is to be issued under an act which authorizes the issue of preferred stock, and not of certificates of indebtedness, referring to it by its title and date, which resolution is made a part of the certificates thereafter issued, such certificates will be held to be certificates of stock, unless, considering the whole transaction, it is clear that the purpose was to create a debt, and unless a debt was in fact created.[2] Where a manufacturing corporation, professing to act under the Ohio act of 1870, providing for the issue of preferred stock to pay debts, issued certificates of preferred stock, so-called, certifying that the corporation *guaranteed* to holders the payment of four per cent. semi-annual dividends, and the final payment of the entire amount at a specified time, with the right to convert the preferred stock

[1] Prouty *v.* Michigan, &c. R. Co., 4 Thomp. & C. (N. Y.) 233.

[2] Miller *v.* Ratterman, 47 Ohio St. 141; *s. c.* 23 Ohio L. J. 416.

into common stock; and the company, at the same time, executed and delivered to a trustee its *bond and mortgage*, to secure the holders of such certificates, — it was held that the holders of the certificates did not thereby become stockholders or members of the corporation, but its creditors; and that, as such creditors, they had a lien upon the mortgage property, superior to that of general creditors of the corporation, or of its assignees.[1]

§ **2278. Preferred Stockholders not Entitled to Priority over Creditors.** — A preferred stockholder, whose contract merely entitles him to dividends *out of profits* in preference to ordinary stockholders cannot, by virtue of his contract, claim a preference over creditors; for any contract which gives him such a preference leaves him out of the category of shareholders and places him in that of preferred creditors. Stated in another way, when the scheme of preference is such that the *status* of the so-called preferred shareholder is really that of a shareholder, and not that of a creditor, he is of course entitled to no preference in winding up the company in the distribution of its assets over its creditors. He is still a *member*, and hence in a sense a *debtor* and not a creditor. Nor does the mere fact that he is entitled to a preference *over other shareholders* in respect of dividends where there are profits to divide, leave him out of this category and entitle him to such a preference in winding up.[2] His rights are to have his preferred dividend in case there is a surplus which can properly be divided among shareholders, and there can be no such surplus so long as debts of the corporation remain unpaid as they mature.[3] And creditors who surrender their debentures for preferred stock remit themselves to this position; for by so doing they cease to be creditors and become shareholders.[4]

§ **2279. Illustration.** — Certificates of preferred stock of the Ohio and Mississippi Railway Company were issued, containing the following

[1] Burt *v.* Rattle, 31 Ohio St. 116.

[2] Re London India Rubber Co., L. R. 5 Eq. 519; Griffith *v.* Paget, 6 Ch. Div. 511.

[3] Warren *v.* King, 108 U. S. 389; aff'g *s. c.* 2 Fed. Rep. 36.

[4] St. John *v.* Erie R. Co., 22 Wall. (U. S.) 136; aff'g *s. c.* 10 Blatchf. (U. S.) 271.

language: "The preferred stock is to be and remain a first claim upon the property of the company after its indebtedness, and the holder thereof shall be entitled to receive from the net earnings of the company seven per cent. per annum, payable semi-annually, and to have such interest paid in full, for each and every year, before any payment of dividends upon the common stock; and whenever the net earnings of the corporation, which shall be applied in the payment of interest on the preferred stock and of dividends on the common stock, shall be more than sufficient to pay both said interest of seven per cent. on the preferred stock in full, and seven per cent. dividend upon the common stock, for the year in which said net earnings are so applied, then the excess of such net earnings after such payments shall be divided upon the preferred and common shares equally, share by share." It was held that the preferred stockholders had no claim on the property superior to that of creditors whose debts were contracted by the company subsequently to the issue of the preferred stock, and that their only valid claim was one to a priority over the holders of common stock.[1]

§ 2280. **Nor over Other Shareholders.** — Nor does a mere right to a preference in receiving dividends *out of profits* give a right of preference over other shareholders in the distribution of the company's assets on a final winding-up. The preferred shareholder is still a shareholder, and is entitled to whatever preference his contract gives him, and to no more.[2]

§ 2281. **Preferred Stock may be Issued without the Right to Vote.** — The ownership of stock in an incorporated company, as a general rule, carries with it the right to vote upon the same at any meeting of the holders of the capital stock. But to this rule there may be exceptions; and it is competent for a railroad company, in issuing certificates of preferred stock, to stipulate therein that the holders shall not have or exercise the right to vote the same, as the owners of the same, at any meeting of the holders of the capital stock of the company.[3]

[1] Warren *v.* King, 108 U. S. 389.

[2] Griffith *v.* Paget, 6 Ch. Div. 511. The separate assent of the preferred shareholders, as a class, is not necessary to an "arrangement" under § 12, of the English Company's Act, 1867. Re Brighton &c. R. Co., 44 Ch. Div. 28.

[3] Miller *v.* Ratterman, 47 Ohio St. 141; *s. c.* 23 Oh. L. J. 416.

§ 2282. Is a Question of Interpretation.— An examination of the cases makes it plain that in most cases the questions which have arisen in respect of the rights of preferential stockholders are questions of *interpretation*, depending on the terms of the particular instruments, rather than general principles of law. Citations could be accumulated of cases depending upon particular states of fact, but to no useful purpose, because the law is a collection of principles and not facts.[1]

§ 2283. Interpretation of the Phrase "Dividends Accruing." — In an action against a corporation for dividends claimed to be due under the terms of a special contract, it appeared that the corporation, on transferring to plaintiff certain shares of its stock in payment of letters-patent assigned by her, agreed "that the dividends accruing" to plaintiff on such shares of stock, "shall amount to at least $219 on or before May 17th, 1886, and to the additional sum of $219 on or before May 17th, 1887." No dividend being declared by May 17, 1886, defendant paid to plaintiff $219. A dividend of five per cent. was declared January 1st, 1887, and plaintiff was paid the same, amounting to $175, and also, on May 17, 1887, the difference between such dividend and $219. In July, 1887, the company declared a dividend of three per cent. but defendant refused to pay plaintiff any more thereof than the proportion earned after May 17. It was held that, as dividends, unlike interest, do not "accrue" until they are declared, the plaintiff, under the terms of her agreement, was entitled to the whole of the July dividend.[2]

§ 2284. "Interest Dividends," Payable "When Able." — If a corporation has voted to pay its stockholders an interest dividend at some future time, when it should be able, and has issued certificates therefor accordingly, the determination of the question whether at any particular time it is able to pay it does not rest in the final decision of the directors, but in that of the court, who, in judging of it, will pay regard not only to the existing liabilities and funds of the corporation, but also to those contingencies to which it is exposed which may require unusual outlays.[3] If the holder of such a certificate can under any

[1] Such cases are: Totten *v.* Tison, 54 Ga. 139; Sullivan *v.* Portland &c. R. Co., 4 Cliff. (U. S.) 212; Bailey *v.* Hannibal &c. R. Co., 1 Dill. (U. S.) 174; Culver *v.* Reno Real Estate Co., 91 Pa. St. 367.

[2] Parks *v.* Automatic Bank Punch Co., 14 Daly (N. Y.), 424; *s. c.* 14 N. Y. St. Rep. 710.

[3] Barnard *v.* Vermont &c. R. Co., 7 Allen (Mass.), 512.

circumstances maintain an action upon it, he can only do so by proof that the company is able to pay the full amount of the interest covered by the vote, either at the time specified therein or at the commencement of the action, without reference to the question whether certificates have been issued for the full amount or not.[1] When, therefore, the stockholders of a railroad corporation voted to pay interest on subscriptions for stock until the completion of the railroad; and, after payment of such interest for some time, and the completion of the road, passed another vote, reciting their pecuniary inability to pay one such dividend in arrear, and authorizing the issue of certificates therefor, payable at a future day named, "with the express understanding and agreement that if there is not sufficient money in the treasury on the day that it falls due," the holders of such scrip should recover *pro rata* so much as the treasurer should be able to pay, and that as soon afterwards as he should be able to pay it he should give notice by advertisement,— it was held that, so long as the treasurer had no funds, the holders of scrip could maintain no action against the company.[2]

§ 2285. Right to Dividends on Preferred Stock under Particular Contracts.[3] — It has been held that holders of preferred stock in a corporation, entitled, by their contract and by the charter, to receive *interest* in preference to the payment of dividends on the common stock, and after payment of the mortgage interest, cannot be deemed prejudiced by the corporation's issuing *mortgage bonds* consolidating prior and subsequent indebtedness.[4] A certificate for shares of stock in a railroad corporation declared that such stock should be entitled to preferred dividends, out of the net earnings, not to exceed a specified rate, after payment of mortgage interest in full. After the certificate was issued, the corporation borrowed money and issued bonds therefor, bearing interest, and also took leases, on rent of connecting railroads. It was held that the holder of the certificate was not entitled to be paid a dividend, before payment of the interest on such bonds or of such rent.[5] The by-laws of a railroad corporation provided that dividends on the preferred stock should "first be made semi-annually from the net earnings of said road," and that no assessment should be made until the full amount necessary to build the road had been subscribed, so as to avoid the necessity of mortgaging. The company, nevertheless, mortgaged its road, and

[1] *Ibid.*

[2] Cunningham *v.* Vermont &c. R. Co., 12 Gray (Mass.), 411.

[3] See Re Dicido Pier Co. (1891), 2 Ch. 355.

[4] Thompson *v.* Erie R. Co., 11 Abb. Pr. (N. S.) (N. Y.) 188; *s. c.* 42 How. Pr. (N. Y.) 68.

[5] St. John *v.* Erie Railway Co., 10 Blatchf. (U. S.) 271.

afterwards leased it, receiving enough rent to pay all interest and pay off some of its floating debt. It was held that the "net earnings" were the gross receipts, less the interest on the permanent debt and the annual contributions to a sinking fund for its payment, less all floating liabilities which in good judgment should be presently paid.[1]

§ 2286. Rights of Preferred Shareholders against Schemes of "Arrangement" under English Railway Companies Act. — The question whether a scheme of arrangement between a railroad company and its creditors is or is not prejudicial to the rights of any class of preference shareholders, within the English Railway Companies Act of 1867, § 15, providing that their consent may be dispensed with where the scheme is not so prejudicial, is *for the shareholders*, and not for the court, to determine.[2]

Article IV. Remedies of Preferred Shareholders.

§ 2289. Remedies for the Enforcement of this Contract. — It would be delusive to say that this right of preference exists by virtue of contract, and at the same time to say that the ordinary legal remedies for the enforcement of the contract do not exist. And herein lies the chief distinction between the rights of the preferred and those of the common stockholder. We have already seen that the common stockholder ordinarily has no remedy to compel the declaration and payment of a dividend.[3] But the general rule is otherwise in regard to preferred shareholders. If the directors refuse to declare and pay dividends to such stockholders in accordance with the terms of the contract, they are obviously entitled to some appropriate remedy to compel the directors to perform the duty or to recover damages for its

[1] Belfast &c. R. Co. *v.* Belfast, 77 Me. 445.

[2] Re Neath &c. R. Co. (C. A.) (1892), 1 Ch. 349.

[3] *Ante*, § 2128.

non-performance; otherwise their right of preference would be merely delusive.

§ 2290. Action at Law. — An *action at law* has been allowed against a corporation on a contract to make a dividend of its earnings;[1] and in a plain case of the breach of such a contract no reason is perceived why such an action would not lie.

§ 2291. Jurisdiction of Equity. — But this would not exclude the jurisdiction of a court of *equity*, which, in cases that might be supposed, would be more effective. There is no difficulty in supporting the jurisdiction of equity, on the theory that the refusal of such a dividend is a *breach of trust* on the part of the directors. The contract which gives the preferred shareholders a right to the dividend out of the net earnings impresses any net earnings in the hands of the directors, for the particular year, with a *trust* in behalf of the preferred shareholders, to the extent required by the terms of the contract. If the directors refuse to perform that trust by making the distribution, a court of equity will, obviously, in a suit in which the parties in interest are made defendants, compel them to do so.[2]

§ 2292. Scope of the Remedy in Equity. — Where the dividends are not paid upon *preferred stock* in pursuance of the terms of a contract, the holders of such stock may maintain an equitable action to compel a specific performance of the contract and to restrain the payment of dividends on the common stock until the arrears of their preferred dividends shall have been paid.[3] "The cause of action," said Miller, J., "is of an equitable character, and the remedy demanded can not be

[1] Bates *v.* Androscoggin &c. R. Co., 49 Me. 491. Compare Taft *v.* Hartford &c. R. Co., 8 R. I. 310; *s. c.* 5 Am. Rep. 575, which was an action of assumpsit.

[2] This was done in Hazeltine *v.* Belfast &c. R. Co., 79 Me. 411; *s. c.* 1 Am. St. Rep. 330; 19 Am. & Eng. Corp. Cas. 456; 10 Atl. Rep. 328; 30 Am. & Eng. R. Cas. 528; 4 New Eng. Rep. 704. See also Ashbury *v.* Watson, L. R. 30 Ch. 376, and New York &c. R Co. *v.* Nickals, 119 U. S. 296 (reversing *s. c.* 21 Blatchf. (U. S.) 177 and Nickals *v.* New York &c. Ry. Co., 15 Fed. Rep. 575); McIntosh *v.* Flint &c. R. Co., 32 Fed. 350; *s. c.* 1 Rail. & Corp. L. J. 299; Boardman *v.* Lake Shore &c. R. Co., 84 N. Y. 157.

[3] Boardman *v.* Lake Shore &c. R. Co., 84 N. Y. 157.

obtained by an action at law. It is not an action to recover the dividends alone, but to compel the defendant to do what is necessary and proper for the specific performance of the contract. * * * The plaintiffs pray that an account be taken, that the defendant be compelled specifically to perform the agreement and enjoined from declaring or paying any dividends upon the common or unpreferred stock of the corporation, until the holders of the guaranteed or construction stock are all paid. Without some action of the officers of the corporation, there is no power to pay the dividends; and as they are to be paid out of net earnings, this cannot be done in any other manner." [1] So, in Virginia it has been held that a suit in equity may be maintained by the holders of *guaranteed stock* to compel the corporation to allow them to participate, equally with the holders of the common stock, in any larger dividends declared in favor of the latter after the payment to the plaintiffs of the preferential or guaranteed dividends; [2] that such a suit is to be treated as a *creditor's bill*, in such a sense that the remedy accorded by the decree settling the rights of the parties, accrues in favor of *all* the guaranteed stockholders, whether parties to the suit or not; that a reference should be made to a *commissioner* to ascertain, state and report who are the other holders of guaranteed stock, and in what shares money dividends are coming to them under the decree settling the rights of the parties; and further, that proper steps should be taken for the allowance of *counsel fees* against the guaranteed stockholders not already represented by counsel.[3]

§ 2293. Action Brought in Behalf of All Other Preferred Shareholders, etc. — An action to secure the application of future earnings of a corporation to the payment of dividends due holders of preferred stock, is properly brought by one of the holders of such stock on his own behalf, and on behalf of others having like grounds of complaint.[4]

[1] *Ibid.*, p. 179.

[2] Gordon *v.* Richmond &c. R. Co., 78 Va. 501.

[3] Gordon *v.* Richmond &c. R. Co. (on second appeal), 81 Va. 621.

[4] Prouty *v.* Michigan &c. R. Co., 4 Thomp. & C. (N. Y.) 230, 241. The court cite, as supporting the propriety of bringing the action in this form, Story Eq. Pl. (7th ed.), §§ 49-103;

§ **2294. Parties Defendant.** — The stockholders not joined as plaintiffs are not necessarily parties defendant; the corporation binds them by representation.[1]

§ **2295. Books of the Corporation Evidence.** — Upon the hearing of such an action, for the purpose of showing authority for the issue of the stock, the book of minutes, containing resolutions of the directors, authorizing the issue, are properly admitted in evidence.[2]

§ **2296. Laches.** — Where preferred stockholders seek a remedy in equity, it may be found that they have lost their rights by *laches*,[3] just as common stockholders may, in consequence of their *laches*, lose their right to undo a scheme by which preferred shares have been issued.[4]

McKenzie *v.* Lamereux, 12 Barb. (N. Y.) 516; Bouton *v.* Brooklyn, 15 *Id.* 375; Hammond *v.* Hudson River &c. Co., 20 *Id.* 378; Cady *v.* Conger, 19 N. Y. 256. See *post*, Ch. 93, Art. I.

[1] Prouty *v.* Michigan &c. R. Co., 4 Thomp. & C. (N. Y.) 230.

[2] Boardman *v.* Lake Shore &c. R. Co., 84 N. Y. 157.

[3] Sullivan *v.* Portland &c. R. Co., 4 Cliff. (U. S.) 212.

[4] *Ante*, § 2153.

CHAPTER XXXVII.

TRANSFERS OF SHARES.

ARTICLE I. RIGHT OF ALIENATION.

§ **2300. General Right of Alienation of Shares.** — The *jus disponendi* being an incident of the ownership of property, the general rule (subject to exceptions hereafter pointed out and discussed) is that every owner of corporate shares has the same uncontrollable right to alien them which attaches to the ownership of any other species of property.[1] The correlative right to purchase corporate shares rests upon similar grounds: the right to become the possessor, by lawful means, of this species of property, is as clear a right as the right so to become the possessor of any other species of property, nor can the *motive* influencing the party who makes such a purchase become the subject of a judicial inquiry, where the motive is not in itself unlawful.[2] Accordingly, it has been held that parties who are interested in opposition to a corporation have the right to purchase its stock in order to defeat a contract which it is about to make.[3]

§ **2301. Right of Directors to Transfer Shares.** — The right to transfer his shares is incident to every shareholder, and is as much the right of a director as of any other member. His exercise of this right will not be affected by his knowledge of the fact that a *call* upon the shares is imminent, unless there is some equity against him as director, such as having been party to a postponement of the call to enable him to get rid of his shares and so evade liability.[4] In Louisiana, this doctrine has been carried to the startling extent of exonerating from all liability,

[1] Trisconi *v.* Winship, 43 La. An. 45; *s. c.* 9 Rail. & Corp. L. J. 469; 9 South. Rep. 29; 33 Am. & Eng. Corp. Cas. 271; *post,* § 2310.

[2] *Post,* §§ 2303, 2305.

[3] Carson *v.* Iowa City Gaslight Co., 80 Iowa, 638; *s. c.* 45 N. W. Rep. 1068. State of facts under which a transfer of shares by one director to another, was held to be a mere private transaction between two individuals, and not a transfer for the benefit to the corporation. Mays *v.* Foster, 13 Or. 214; *s. c.* 10 Pac. Rep. 17.

[4] Re Cawley, 42 Ch. Div. 209; *s. c.* 31 Am. & Eng. Corp. Cas. 425.

the directors of an oil works company who traded their stock to the agents of the "American Oil Trust" for certificates in the latter, enabling the agents of the "oil trust," by acquiring a majority of the stock of the company, to control its operations and ultimately to wreck it, to the great loss of the complaining stockholders.[1]

§ 2302. Right of State to Transfer Its Shares. — On general and obvious grounds, if the State becomes a shareholder in a private corporation it possesses the same right to transfer its shares as that possessed by any other shareholder.[2]

§ 2303. Purpose of Transfer. — In the absence of allegations of fraud, the purpose with which stock was transferred will not be inquired into, and it has been held that the transferee of stock upon the corporate records is qualified to vote and become a director, although the transfer was made for the express and sole purpose of so qualifying him.[3]

§ 2304. Transfers in Fraud of the Creditors of the Transferor. — Transfers of corporate shares, made upon *secret trusts* for the transferor, and intended to hinder, delay and defraud his creditors, rest on much the same footing as other fraudulent transfers of personality made with the same motive. Such a transfer is good as between the parties; and hence, if the transferee himself becomes insolvent, a court will not aid the transferor in getting back his shares, especially where it appears that the creditors of the fraudulent assignee have given him credit on the faith of his being the owner of them.[4] One court has held that the failure to perfect such a transfer by the proper entry in the books of the corporation is *prima facie* evidence of a secret trust to the use of the transferor, which, unexplained,

[1] Trisconi *v.* Winship, 43 La. Ann. 45; *s. c.* 9 Rail *v.* Corp. L. J. 469; 9 South. Rep. 29; 33 Am. & Eng. Corp. Cas. 271.

[2] La Grange &c. R. Co. *v.* Rainey, 7 Coldw. (Tenn.) 420. See *ante*, § 1133.

[3] Re Argus Printing Co., 1. N. Dak. 434; *s. c.* 12 L. R. A. 781; 9 Ry. & Corp. L. J. 462; 48 N. W. Rep. 347; *ante*, § 2300; *post*, § 2305.

[4] Hirsch *v.* Norton, 115 Ind. 341; *s. c.* 17 N. E. Rep. 612; 15 West. Rep. 318.

becomes conclusive and renders the transfer void as against creditors as a matter of law.[1]

§ 2305. **Temporary Transfers to Convey Incidental Benefit.** — Again, circumstances may arise where a temporary transfer of shares of corporate stock intended merely to convey an incidental benefit will have the effect of conferring the benefit without vesting the transferee with title to the shares. Such a transaction will be construed with the purpose of carrying out the real intent of the parties. Thus, where a charter of a corporation organized to erect and maintain a theater provided that every five shares of stock should entitle the holder to a free ticket of admission, and that the directors should set apart a certain portion of the house for the exclusive use of such stockholders; and certain stockholders, holding large amounts of the stock, made transfers of small lots to other persons, with the understanding that the same stock was to be retransferred at the end of the season,— it was held that the temporary transferees did not become owners of the stock in the sense which entitled them to the tickets; that such transfers were illegal and would be enjoined.[2]

§ 2306. **Contract of Future Sale of Stock by Subscriber to Proposed Company.**— It was urged, in a case before the Supreme Court of the United States that, notwithstanding the stockholder's right to make an absolute sale of his stock, the policy of the law forbids a subscriber to the stock of a proposed cor-

[1] Pinkerton *v.* Manchester &c. R. Co., 42 N. H. 424. In an action under Rev. Stat. Me. ch. 113, § 47, which provides that any one assisting a debtor in the fraudulent transfer of his property shall be liable in twice its value, it was held that the defendant could not deny his title to certain shares of a corporation, which he had received and sold, because the indorsement upon the certificate by the fraudulent debtor was of the within "share" when the certificate was for five shares. Skowhegan Bank *v.* Cutler, 52 Me. 509. The liability of a person as the indorser of a promissory note, to the holder, is a sufficient *consideration* to support a transfer of bank shares, by the former as security to the latter for such liability. Stamford Bank *v.* Ferris, 17 Conn. 259. A transfer of shares to A. as president of a bank, has been held not within the provisions of a statute avoiding all assignments for the benefit of moneyed corporations, unless made to them by name. Leavitt *v.* Fisher, 4 Duer (N. Y.), 1.

[2] Baker's Appeal, 108 Pa. St. 510; *s. c.* 56 Am. Rep. 231.

poration, whose act of subscription may be held out as an inducement to others to subscribe, from making a contract for future sale, with a view to secure his investment; and, that such a contract is void, because many co-stockholders "may have been chiefly induced to subscribe by a knowledge that so prominent and successful an operator was willing to risk his money in such an adventure," "who, had they been told that he had exacted a private security or guaranty, which availed to give him the benefit of both the experiment in business, and of getting back his money with interest, if it did not succeed, would assuredly either have refused to subscribe, or have demanded a similar guar anty," and who also had a right to suppose that the new company would have the subscriber's countenance and assistance in the future. The court held that such a view was a palpable misconception of the nature of the transaction; that it is just in this respect, especially, that an incorporated joint-stock company differs from an ordinary co-partnership; for in the latter, the individual members of the firm are presumed to, and in general, actually do contribute, to the common enterprise, not only their several shares of partnership capital, but also their individual skill, experience or credit, no member having the right to sell out his interest, or retire from the firm, without the consent of the co-partners, and that if he does either, the act amounts to a dissolution of the partnership; that the very reverse is the case of a joint-stock corporation, in which each stockholder, whether by purchase or original subscription, has the right, unless restrained by the charter or articles of association, to sell and transfer his shares, and, by transferring them, introduce others in his stead.[1]

§ **2307. Transfer by Minor.** — Like other contracts of a minor, a transfer of shares of stock is voidable, not void. It is one of those acts which may or may not be for the interest of the minor. The sale being voidable only, the company must register the transfer, if it has not been avoided at the date of the application for registration.[2]

[1] Smith *v.* Nashville &c. R. Co., 91 Tenn. 221; *s. c.* 18 S. W. Rep. 546; *post*, § 2533.

[2] Smith *v.* Nashville &c. R. Co. 91 Tenn. 221; *s. c.* 18 S. W. Rep. 546; *post*, § 2533.

§ 2308. Transfer after Dissolution. — By the dissolution of a banking corporation the transferable nature of the stock is destroyed, and a subsequent sale, by a holder of stock at the time of the dissolution, transfers only his right to the balance which may be found due him after paying all his debts due the bank.[1] And so, in the case of a sale and transfer of shares after a compulsory winding-up order under the English Companies Act,[2] the transferee is not entitled to be registered as the owner without the sanction of the court; and it has been held that the court's power to order the insertion of such transferee's name in the register of members is discretionary and will not be exercised in favor of transferees, who hold only as representing a company engaged in speculating in such shares, and which purchased them at a discount.[3]

§ 2309. Transferability of Shares in an Unincorporated Joint Stock Company. — Shares in an *unincorporated joint-stock company*, whose property is held in the name of a trustee, are *equitable interests*, which can be sold, pledged or mortgaged in like manner as shares in a corporation, so that the transferee will acquire such an interest as a court of equity will protect.[4]

§ 2310. General Rule that a Corporation has no Power to Restrain Transfers of its Shares. — It may be stated as a general principle, that unless the charter, or the original compact among the corporators, gives to the corporation the power to restrain the alienation of the shares of its members, it cannot,

James *v.* Woodruff, 10 Paige (N. Y.), 541.

[2] 25 & 26 Vict., c. 89, §§ 35, 87, 98 and 153.

[3] Re Onward Building Soc. (1891), 2 Q. B. 463.

[4] Several persons associated themselves together, intending to buy land, build mills and commence a city, the property to be holden by a trustee. The nominal capital was divided into shares, and transferable certificates therefor were issued to the parties in interest, and were expressed to be subject to all the provisions, etc., of the articles of association. It was held that these certificates represented an equitable interest in the whole property, real and personal, which a court of equity would protect, and which could be sold, pledged or mortgaged by the owner of the certificate, like any other species of property, and that thereupon the transferee would take such an interest in the company's property as equity would recognize and protect. Durkee *v.* Stringham, 8 Wis. 1.

by the mere passing of a *by-law*, impose such a restraint upon any dissenting shareholder. As against him such a restraint, not being warranted by the governing statute or by the terms of the original compact, would be void as in *restraint of trade.*[1] One court has gone even further, and held that a by-law which requires the *consent of all the stockholders* to a transfer of the stock of one of them is void as against public policy; and that it does not matter that the stockholder who objects to the enforcement of the by-law originally voted for it.[2] From this the conclusion easily follows that a charter power to "regulate" the transfer of *shares* does not include the power to *prevent* such transfers, nor to prescribe to whom the owner may sell and to whom not, or on what terms.[3]

§ 2311. Except in Case of Unanimous Agreement, Saving Rights of Third Persons.—Referring to this decision, the writer suggests that there is no principle of public policy which is in any way concerned in prohibiting the shareholders of a corporation from agreeing not to transfer their shares without unanimous consent, any more than there would be in prohibiting such an agreement among the members of an unincorporated joint-stock company. Such an agreement is made in the case of nearly every partnership, and the inability of one partner to sell his interest to another and to introduce that other in his stead without the consent of his copartners is, as we have seen, one of the chief points of distinction between a partnership and a corporation.[4] The question of the effect of such an agreement upon the rights of *third persons* purchasing shares in a company without notice of it, would of course be a different question.[5]

[1] Moore *v.* Bank of Commerce, 52 Mo. 377; *ante*, § 1031.

[2] Re Klaus, 67 Wis. 401; *s. c.* 29 N. W. Rep. 582.

[3] Chouteau Spring Co. *v.* Harris, 20 Mo. 382.

[4] *Ante*, § 13.

[5] It has been held that a by-law of a corporation which provides that transfers of stock shall not be valid unless approved by the board of directors cannot be made available to defeat the rights of third persons. Farmers' &c. Bank *v.* Wasson, 48 Iowa, 336; *s. c.* 30 Am. Rep. 398. The subject of stock as personal property, with special reference to prohibitions concerning its transfer, has been discussed and English and American decisions collected by Adelbert Hamilton, Esq., in 26 Am. L. Reg. (N. S.) 104 *n.*

§ 2312. Transfer Offices Required to be Kept.— Constitutional provisions and statutes exist in many of the States requiring corporations to keep offices for the register and transfer of their stock and other data. Of these the following are given as examples: "Every corporation, other than religious, educational or benevolent, organized or doing business in this State, shall have and maintain an office or place in this State for the transaction of its business, where transfers of stock shall be made, and in which shall be kept for inspection by every person having an interest therein, and legislative committees, books in which shall be recorded the amount of capital stock subscribed, and by whom; the names of the owners of its stock, and the amounts owned by them respectively; the amount of stock paid in, and by whom; the transfers of stock; the amount of its assets and liabilities, and the names and place of residence of its officers."[1] - - - - "Every railroad or other corporation, organized or doing business in this State under the laws or authority thereof, shall have and maintain a public office or place in this State for the transaction of its business, where transfers of stock shall be made, and where shall be kept for inspection by the stockholders of such corporations, books, in which shall be recorded the amount of capital stock subscribed, the names of the owners of the stock, the amount owned by them respectively, the amount of stock paid, and by whom, the transfer of stock with the date of the transfer, the amount of its assets and liabilities, and the names and places of residence of its officers. The directors of every railroad company shall hold one meeting annually in this State, public notice of which shall be given thirty days previously, and the president or superintendent shall report annually, under oath, to the comptroller or governor, their acts and doings, which report shall include such matters relating to railroads as may be prescribed by law. The legislature shall pass laws enforcing by suitable penalties the provisions of this section."[2]

§ 2313. Incidental Rights not Following Transfers.— It has been held that the purchaser of bank stock subsequent to a dissolution of the corporation, is not entitled to the benefit of securities for the payment of the stock notes, given by a mere surety of the vendor.[3] - - - - A vote by the proprietors of a bridge that "all the present proprietors of stock therein shall have the right to pass, free of toll, with their horses and carriages," is confined to persons who are then

[1] Cal. Const. 1879, art. 12, § 14.

[2] Tex. Const. of 1876, art. 10, § 3.

[3] James *v.* Woodruff, 10 Paige (N. Y.), 541.

proprietors of the bridge, and does not extend to those who subsequently become the purchasers of stock then existing.[1]

Article II. Lien of Corporation on its Shares.

§ 2317. Corporation has no Implied Lien on Shares of Stock. — Nearly related to the stockholder's right of alienation of his shares, which we have just discussed, is the right of the company to restrain such transfer, by the assertion of a lien upon the stock for the indebtedness of the stockholder to itself.[2] It has been generally held that no such lien exists, in the absence of statutory authority.[3] Thus, in an Iowa case, the

[1] Central Bridge *v.* Abbott, 4 Cush. (Mass.) 473.

[2] *Ante,* §§ 1031, 1032, 1680, *et seq.*

[3] Gemmell *v.* Davis, 75 Md. 546; 32 Am. St. 412; Farmers' &c. Bank *v.* Wasson, 48 Iowa, 336; *s. c.* 30 Am. Rep. 398; Massachusetts Iron Co. *v.* Hooper, 7 Cush. (Mass.) 183; Sargent *v.* Franklin Ins. Co., 8 Pick. (Mass.), 90; Heart *v.* State Bank, 2 Dev. Eq. (N. C.) 111;

president of a bank, who was a surety on the note of a stockholder, took an assignment of the latter's stock in the bank to secure himself against loss; the stockholder was at the time also a debtor of the bank and in failing circumstances. It was held that, in the absence of any concealment on the president's part, there was nothing in the transaction to give the bank a claim in equity to the benefit of the security.[1] The absence of any such lien is one of the elementary differences between a joint-stock company and a partnership. The firm may claim a priority for its demand against the estate of an insolvent partner, over his individual creditors, to the extent of his share of the firm assets. He has no share, in fact, until all his dues are paid. But a corporation is a body politic, and a distinct person, in law, from all its members, which may contract with, sue and be sued by, any of its members; no member has any specific interest or right of property in the money, goods and effects of which the stock is composed; they are the property of the corporation. Shares in the company are regarded as a distinct estate, salable, transferable and attachable, as personal property. There is nothing in the mere relation of the stockholder to the company which should give rise to such a lien.[2] The denial of such a lien has also been put on the ground that a different ruling would subvert the wholesome rule of the common law against *secret liens*.[3]

§ 2318. **Rule as to Dividends.** — It has been claimed, however, that a different rule prevails as to dividends, that the company has a right of set-off, amounting, in effect, to a lien, on unpaid dividends of an indebted stockholder. Said the Maryland Court of Appeals: "It rests upon an entirely different principle. It is the right of set-off, for the dividend is a sim-

Dana *v.* Brown, 1 J. J. Marsh. (Ky.) 304; Steamship Dock Co. *v.* Heron, 52 Pa. St. 280; Merchants' Bank *v.* Shouse, 102 Pa. St. 488; Fitzhugh *v.* Bank of Shepardville, 3 T. B. Mon. (Ky.) 26; Williams *v.* Lowe, 4 Neb. 382, 398; Murray *v.* Pinkett, 12 Cl. & Fin. 764; *s. c. sub nom.* Pinkett *v.* Wright, 2 Hare, 120; Bell's Appeal, *s. c.* 115 Pa. St. 88; 2 Am. St. Rep. 532. A similar rule prevails in Louisiana. New Orleans Nat. Banking Assn. *v.* Wiltz, 40 Fed. Rep. 330.

[1] Farmers &c. Bank *v.* Wasson, 48 Iowa, 336; *s. c.* 30 Am. Rep. 398.

[2] Massachusetts Iron Co. *v.* Hooper, 7 Cush. (Mass.) 183; Farmers &c. Bank *v.* Wasson, 48 Ia. 336; *s. c.* 30 Am. Rep. 398. Compare Lindley on Companies, 5th ed., p. 456.

[3] Steamship Dock Co. *v.* Heron, 52 Pa. St. 280.

ple debt owing from the corporation to the shareholder. As in every other case to which this doctrine of set-off is applicable, the debt — that is, the dividend — due by the corporation must be payable by it to the person from whom the obligation to the corporation is demandable. If the stock has passed into the hands of a third party before the dividend has been declared, the right of set-off is gone, because a dividend declared after a transfer of stock has been made belongs to the assignee, and not the assignor." [1] But such a rule could hardly apply where the rights of third parties have intervened, as in the case of an insolvent stockholder. Under such circumstances it was held, in an early case, that a bank, though entitled under its charter, to a lien on stock, which it could only enforce by refusal to permit transfers, had no specific lien on dividends accruing after the death of the stockholder, insolvent, and no right of set-off against the insolvent estate.[2]

§ 2319. National Banks Have no Lien.—It has been held that national banks organized under the National Banking Act of 1864,[3] have no such lien on the shares of their stockholders, for indebtedness due from them; and that provisions, framed with a direct view to that effect, in the *articles of association* of such a bank, and *by-laws* in pursuance thereof, are void, as being incompatible with the prohibition,[4] of loans and discounts by any bank on the security of the shares of its own capital stock, and also, with the repeal, by that act, of the provision, in the act of 1863,[5] that no shareholder shall have power to transfer or sell his shares, so long as he is liable for any debt to the bank.[6]

§ 2320. Lien Created by Charter or Statute. — The charter of the corporation, or the governing statute, or the articles of association or deed of settlement under the English system,

[1] Gemmell *v.* Davis, 75 Md. 545; *s. c.* 32 Am. St. Rep. 412; 23 Atl. Rep. 1032; *ante*, § 2133.

[2] Brent *v.* Bank of Washington, 2 Cranch. C. C. (U. S.) 517.

[3] 13 U. S. Stat. 99; U. S. Rev. St., § 5133, *et seq.*

[4] *Id.*, § 35, p. 110; U. S. Rev. St., § 5201.

[5] 12 U. S. Stat. at L. 675, § 36.

[6] Bullard *v.* Bank, 18 Wall. (U. S.) 589. See to the same effect Bank *v.* Lanier, 11 Wall. (U. S.) 369; Goodbar *v.* City National Bank, 78 Tex. 461; *s. c.* 14 S. W. Rep. 851. Compare Rosenback *v.* Salt Springs National Bank, 53 Barb. (N. Y.) 495. *Contra*, Knight *v.* The Old National Bank, 3 Cliff. (U. S.) 429; Young *v.* Vough, 23 N. J. Eq. 325.

if authorized by the statute, may, in fixing the terms of the contract between the company and its shareholders, provide for such a lien.[1] A provision in the charter which goes no further than to say that the shares shall be transferable only on the books, and prohibiting such transfers by a stockholder who is indebted to the corporation, except by consent of the president and directors, has been held to have that effect.[2] The same ruling was made, in regard to a similar provision in a general incorporation law, the terms of which were declared to be applicable to companies thereafter incorporated by special act, when not otherwise expressly provided.[3] And where the articles of association of a bank provided that no stockholder should be permitted to transfer his shares or receive a dividend thereon, who should owe the bank any debt then due, unless by consent, etc., and authority was given whenever such a debt was past due, to sell the stock and apply the proceeds to pay the same, — it was held that these two provisions, taken together, created a lien upon the stock, in favor of the bank, for the holder's debts to it.[4] But, in an English case where, in addition to a prohibition against transfers, until the payment of all moneys due to the company, the deed of settlement contained a provision that, upon failure of the shareholder to pay on demand any money due from him to the company, the directors might declare a forfeiture of his shares; and that such a forfeiture should not discharge the debtor, but that he should continue liable, — the Court of Appeal held that no lien was created. Said Jessel, M. R.: "Whatever we may think of the justice and equity of such provisions, it is plain that if the bank forfeits the shares for the

[1] Hague *v.* Dandeson, 2 Exch. 740; Ex parte Plant, 4 Deac. & Ch. 160; Re Lewis, L. R. 6 Ch. 818; New London &c. Bank *v.* Brocklebank, 21 Ch. Div. 302; Stockton Malleable Iron Co., 2 Ch. Div. 101; Re London &c. Banking Co., 34 Beav. 332.

[2] Union Bank *v.* Laird, 2 Wheat. (U. S.) 390; Mechanics' Bank *v.* Seton, 1 Pet. (U. S.) 299; Brent *v.* Bank of Washington, 10 Pet. (U. S.) 596, 614; National Bank *v.* Watsontown Bank, 105 U. S. 217, 220; Kenton Insurance Co. *v.* Bowman, 84 Ky. 430; Pierson *v.* Bank of Washington, 3 Cranch. C. C. (U. S.) 363; Farmers Bank of Maryland *v.* Iglehart, 6 Gill (Md.), 50; Rogers *v.* Huntington Bank, 12 Serg. & R. (Pa.) 77.

[3] Mount Holly Paper Co.'s Appeal, 99 Pa. St. 513.

[4] Arnold *v.* Suffolk Bank, 27 Barb. (N. Y.) 424. Compare Rosenback *v.* Salt Springs National Bank, 53 Barb. (N. Y.) 495.

non-payment of a debt, the debt still remains due. I cannot see how this can be considered a security for payment. It is a penalty for non-payment. The shares are not applied in payment of the debt, which they must be if they were a security for it." Of the provision against transfers he said that it "does not carry the matter further. The shareholders are partners, and by general law a partner cannot retire without the consent of all the other partners. That clause gives him power to transfer his shares on condition that his debts to the company are paid. How can that be a security?" [1] This language happily illustrates the radical distinction between the English conception of a joint-stock company as a partnership, with special powers, and the American idea of a corporation as a body politic with a separate legal existence.

§ 2321. **Creation of Lien by By-Law.** — The power of making by-laws, for the regulation of its internal affairs, usually granted to a corporation by its charter or articles of association, has been frequently exercised with a view to the creation of such a lien, and in many instances such by-laws have been held valid. Thus, under a Missouri charter, declaring the stock of the corporation personal property, and authorizing the board of directors to make rules and regulations concerning the transfer of the stock, subject to the general law of the State, it was held that the board was authorized to adopt a rule prohibiting the transfer of stock until all the debts due by the owner of the stock to the corporation should have been paid, although such rule was inconsistent with the general policy of the law of the State favoring the free transfer of personal property.[2] The grant of the power to a corporation to "regulate" transfers of its stock has been very generally held sufficient to authorize such a by-law.[3] Where the company has such power

[1] Dunlop *v.* Dunlop, 21 Ch. Div. 583.

[2] St. Louis Perpetual Ins. Co. *v.* Goodfellow, 9 Mo. 149. See, to the same effect, Mechanics' Bank *v.* Merchants' Bank, 45 Mo. 513; *s. c.* 100 Am. Dec. 388; Spurlock *v.* Pacific Railroad, 61 Mo. 319. Compare Tuttle *v.* Walton, 1 Ga. 43; *ante*, § 1032.

[3] Cunningham *v.* Alabama Life Ins. &c. Co., 4 Ala. 652; Pendergast *v.* Bank of Stockton, 2 Sawy. (U. S.) 108; Geyer *v.* Western Insurance Co., 3 Pittsb. (Pa.) 41; McCready *v.* Rum-

it must be shown, in order to establish a valid lien, that it was duly exercised. Thus, if the power to enact by-laws is vested in the corporation, rather than in the board of directors, it must be exercised by the stockholders; and a mere adoption by the directors of such a rule, will not create the lien.[1]

§ 2322. Equitable Lien Arising from Language of Certificate.— In still another class of cases, a lien is implied, from the acceptance by the stockholder of a certificate to his shares, which in terms reserves such a lien to the company. Thus, where the defendant company's charter provided that they might establish and put in execution such by-laws, ordinances and regulations as should be deemed expedient, for the well-ordering of the concerns of the corporation, and it was conceded that no by-law had been passed by the company, giving it a lien on the shares of its stockholders for their indebtedness to it, — it was nevertheless held, that the acceptance by the stockholder, without objection, of a certificate, which declared the stock to be transferable only at the office of the company on the surrender of the certificate, "subject nevertheless to his indebtedness and liabilities," was tantamount to an agreement on his part that his stock should be subject to such a lien.[2] A similar ruling was made by the Supreme Court of California, in a case in which the condition inserted in the certificate was that no transfer would be made "until after the payment of all indebtedness due the bank by the person in whose name the stock stands," and it appeared that the certificate was so framed by the president, cashier and secretary of the bank, without the authority of the board of directors. The court held that the acceptance of such a certificate by the stockholder and the subsequent borrowing of money from the bank, without anything to exclude the idea that the condition was to be binding, amounted to an assent to it, so far as the particular loan was concerned, and that a contract must be implied that the stock was to stand upon the books as secur-

sey, 6 Duer (N. Y.), 574. *Contra*, Bank of Attica *v.* Manufacturers' &c. Bank, 20 N. Y. 501. Compare Nesmith *v.* Washington Bank, 6 Pick. (Mass.) 324; Plymoth Bank *v.* Bank of Norfolk, 10 Pick. (Mass.) 454.

[1] Carroll *v.* Mullanphy Savings Bank, 8 Mo. App. 249.

[2] Vansands *v.* Middlesex County Bank, 26 Conn. 144.

ity for the loan.[1] But where the certificate contains no language importing a lien in favor of the corporation, then the general rule is that it is a *continuing affirmation* of the ownership of the special amount of stock by the person designated therein or his assignee, and that a purchaser has a right to rely thereon and claim the benefit of an *estoppel* in his favor as against the corporation.[2]

§ 2323. Construction of Language Creating the Lien: "Registered Holder." — A company whose articles of association provide that it shall have a first and paramount lien on all shares for money due from the "registered holder," or other persons for the time being entitled thereto, is not bound to recognize *trusts of its shares*, and consequently has no lien upon the shares for a debt due the company from one who has obtained a judgment against a registered shareholder declaring the latter a trustee of the stock for his benefit; and the company is not a "secured creditor" within the English Bankruptcy Act of 1883.[3]

§ 2324. Company's Power to Lend to Stockholders not Enlarged. — A provision of a corporate charter giving the corporation a lien upon its shares belonging to its stockholders, by way of security from them to it, does not operate as a special legislative permission to the stockholders to borrow, or to the corporation to lend to them, its capital. If the corporation should be compelled to make good a negotiable acceptance made by its treasurer in excess of his power for the accommodation of a stockholder, it could regain the amount paid, from shares of its stock or from any other property belonging to him; the unlawfulness of the acceptance would be no bar in his behalf against such recovery. But the existence of the right to recover the money from the shares or from any other property does not, where the company is limited by its charter in its use of mercantile paper, to that necessary for the convenient prosecution of its business, make the acceptance lawful; does not put an indorsee thereof in the position of a *bona fide holder* of negotiable

[1] Jennings *v.* Bank of California, 79 Cal. 323; *s. c.* 12 Am. St. Rep. 145; 21 Pac. Rep. 852; 29 Cent. L. J. 150.

[2] Kisterbock's Appeal, 127 Pa. St. 601; *s. c.* 14 Am. St. Rep. 868. See *ante*, § 1680, *et seq.*

[3] Re Perkins (C. A.), 24 Q. B. Div. 613.

paper issued by a corporation within the power given by its charter.[1]

§ 2325. **Enforcing the Lien: Marshaling Securities.** — In availing itself of its right of lien on its stockholders' shares, a corporation is subject to the rules, prevailing in courts of equity, in reference to marshaling securities. Thus, where a bank, having such a lien under its charter, has applied the whole of the proceeds of the bank stock to the payment of the debt due by the stockholder, equity demands that the bank shall be postponed until the general creditors have been made equal out of the general estate, when the residue will be distributed *pro rata* among all the creditors.[2] And where the statute gives the company no lien on the stock for any other debts of the stockholder than for unpaid stock, the indorser of a note given for stock is entitled to have the stock applied to pay that debt, in preference to other debts due from his principal to the company, even though one of its by-laws provides that the interest of any stockholder shall be liable for the payment of all debts which may be due from him to the company, and that if there is more than one debt, the board of directors may prescribe which one shall be paid out of the debtor's stock. Such by-law can only apply to the interest of the debtor stockholder in the stock after the lien of the stock debt is satisfied.[3]

§ 2326. **Foreclosure Under Decree: Day of Grace.** — A decree foreclosing the lien of a banking corporation on its debtor's stock need not give the debtor a day within which to pay the debt, unless some applicatory statute so provides.[4]

§ 2327. **Indebtedness to Support the Lien.** — The question as to what indebtedness will support the lien depends largely upon the language of the statute, charter, or by-law, by which it is created. Thus, under articles of association in pursuance of

[1] Webster *v.* Howe Machine Co., 54 Conn. 394; *s. c.* 8 Atl. Rep. 482; 3 New Eng. Rep. 567.

[2] German Security Bank *v.* Jefferson, 10 Bush (Ky.), 326.

[3] Petersburg Savings &c. Co. *v.* Lumsden, 75 Va. 327.

[4] Reese *v.* Bank of Commerce, 14 Md. 271; *s. c.* 74 Am. Dec. 536.

the English Companies Act,[1] providing that the directors should have discretion to refuse registration of the transfer, where the shareholder was "indebted to the company in respect of calls or otherwise," — it was held that until a call had been made, the shareholder was not indebted for the unpaid portion of his shares, and that no lien accrued.[2] A resolution for a call on stock, which does not fix the *date* when it is to be paid, does not constitute a call which will create an indebtedness to prevent registration of a transfer of shares; and a subsequent resolution completing the call by supplying the date will not relate back for that purpose.[3] Where the governing statute gave to corporations at "all times" a *lien* on members' stock for "all" the debts due from them to the corporation,[4] the court held that the lien attached, whether the debt accrued before or after a member's acquisition of stock.[5] And a lien, in the language of the charter, "for all debts and liabilities," was held to include, not only debts due for stock, but also all debts due from the stockholder prior to notice of the assignment of his stock.[6] And a by-law restraining transfers while the stockholder "is indebted to the company" was held to apply to an indebtedness not yet due,[7] and also where the obligation of the stockholder was merely that of a surety on a debt due to the company.[8]

§ 2328. Continued: Debts of Equitable Owners of Shares. — Such a lien has been held to extend not merely to the debts and liabilities of the nominal shareholder, but to embrace debts contracted by the equitable owners of the stock known by the company to be such owners. Thus, on the dissolution of a firm owning stock in a bank, the retiring partner sold out his interest to the others, who assumed the debts of the partnership and continued the business under a new name. No formal

[1] Companies Act, 1862, § 35.

[2] Re Cawley, 2 Ch. Div. 209; *s. c.* 31 Am. & Eng. Corp. Cas. 425; *ante*, § 1702, 2003.

[3] *Ibid.*

[4] Minn. Gen. St., ch. 34, § 114.

[5] Schmidt *v.* Hennepin County Barrel Co., 35 Minn. 511; *s. c.* 29 N. W. Rep. 200.

[6] Mobile Mutual Ins. Co. *v.* Cullom, 49 Ala. 558. See also Rogers *v.* Huntington Bank, 12 Serg. & R. (Pa.) 77.

[7] St. Louis Perpetual Ins. Co. *v.* Goodfellow, 9 Mo. 149. See also Re London &c. Banking Co., 34 Beav. 332.

[8] *Ibid.*

transfer was made on the books of the company, but the new firm, as the successor of the old, became the equitable owners of the stock. It was held that the bank's lien covered the liabilities of the new firm in its subsequent transactions with the bank, and must prevail over the claim of an equitable assignee of the retiring partner.[1]

§ 2329. Continued: Debt of Nominal Owner of Shares held in Trust. — In an English case, where the articles of association gave the company a final and paramount charge on the shares of any shareholder, for all moneys owing the company, from him alone or jointly with any other person, and provided that when a share was held by more persons than one, the company should have a like lien and charge thereon in respect to all moneys so owing to it from all or any of the holders thereof, alone or jointly with any other person, — the trustees of a marriage settlement invested a part of their trust funds in shares of the company, which were transferred into their joint names. One of the trustees was a partner in a firm which afterwards went into liquidation, at which time it owed the company a debt which had arisen long after the registration of the shares in the names of the trustees. It was held by the Court of Appeal that the company had a lien on the shares for this debt, which must prevail over the title of the *cestuis que trust*. Said Jessel, M. R.: "It is said on behalf of appellants that Mee was a trustee for others; that he bought these shares with other people's money, being duly authorized so to purchase them, and held them on their behalf; and that the debt to the company, having arisen since the purchase, must be postponed in equity to the equitable rights of the *cestuis que trust*, on the ground that the equitable charge which is first in time, is first in right. The answer to that is, that the charge of the bank is first in right, and indeed first in time. The charge of the bank took effect as one of the terms on which the registration was made. It was this: 'We admit you, Mee, as a shareholder in this bank on the terms that, whenever you owe us any money, we shall have an equitable charge on these shares.' That contract was perfect at the moment when the

[1] Planters' &c. Ins. Co. *v.* Selma Savings Bank, 63 Ala. 585.

shares were registered; there is no possibility therefore, of the title of the *cestuis que trust* being prior. That alone would be conclusive; but there is another ground equally conclusive, which is this: The *cestui que trust* buys, in the name of the trustee, property subject to a charge in a given event. Can that *cestui que trust* get the benefit of the purchase, and not comply with the terms?"[1]

§ 2330. Continued: Invalid Demand.— A demand that is invalid, without warrant of law, will not, of course, support such a lien. Thus, where a deceased stockholder had left stock pledged to the company for his indebtedness, and his executor, who was also president of the company, made unauthorized payments from the funds of the company to the widow, — it was held that the lien on the stock would not extend to such additional indebtedness.[2]

§ 2331. Time of Ascertaining the Fact of Indebtedness.— Where the articles of association of a limited company gave the directors discretion to refuse to register a transfer of shares by a shareholder if he was indebted to the company, it was held that the time at which it was to be ascertained whether he was indebted or not, was the time when the transfer was sent to the proper officer for registration, and not when it subsequently came before a meeting of the board for registration.[3]

§ 2332. Effect of the Lien. — Where a valid lien exists, whether by force of statute or otherwise, so that it is good as against third persons, a purchaser, pledgee, or other transferee of the shares takes them subject to the lien,[4] in such a sense that a sale of the shares by the corporation to enforce the lien divests his title.[5] And where the lien attaches for the security of debts not yet due, the corporation may refuse to transfer until the debts are paid.[6] If the corporation is operating under

1 New London &c. Bank *v.* Brocklebank, 21 Ch. Div. 302.

2 Reading Fire Ins. &c. Co. *v.* Reading Iron Works, 137 Pa. St. 282; *s. c.* 27 W. N. C. (Pa.) 95; 21 Pitts. L. J. (N. S.) 210; 48 Phila. Leg. Int. 108; 21 Atl. Rep. 169.

3 Re Cawley, 42 Ch. Div. 209; *s. c.* 31 Am. & Eng. Corp. Cas. 425.

4 Union Bank *v.* Laird, 2 Wheat. (U. S.) 390.

5 West Branch Bank *v.* Armstrong, 40 Pa. St. 278.

6 Where an assignee demands a

a special *charter*, and the lien is created by the charter, the assignee of the shares is bound to take *notice* of it;[1] and if the certificate has printed thereon a by-law imposing certain *conditions* on the transfer of the stock, a pledgee of it is put upon inquiry as to such conditions, and does not occupy the position of an innocent purchaser.[2] Sometimes under the terms of the law creating it, a lien for unpaid *calls* extends only to the particular shares as to which the stockholder is in default, and as to other shares his right of *transfer* is unimpaired.[3]

§ 2333. Notice of Lien when Created by General Law.— Where, by the general law, a lien is given to a corporation upon its stock for the indebtedness of the stockholder, it is valid and enforceable against all the world; whoever deals with it is charged with notice of all limitations and burdens attached to it by such statute, whether the party lives in or out of the State.[4] The same rule obtains where, under the general law, an assignment of corporate stock is not valid as to third persons unless it is entered on the books; and an assignee of a stock certificate of a bank, from one who is in debt to the bank, which certificate provides that the transfer shall not be entered on the books until the holder has paid all he owes, is not a *bona fide* purchaser; and the equitable lien held by the bank on the stock for the amount due it from the original holder is retained as against such assignee, and it will extend to subsequent advances or loans made to the assignor, where the assignee gives no notice of the assignment.[5]

§ 2334. Notice of Lien when Created by By-Law or Contract.— But where the corporation itself asserts a right of lien

transfer, but refuses to pay the debts then due the bank by the stockholder, and afterwards makes a second demand when other notes of the stockholder had become due and payable, he cannot obtain a transfer without paying all the debts due at the time of the last demand. Reese *v.* Bank of Commerce, 14 Md. 271; *s. c.* 74 Am. Dec. 536.

[1] Union Bank *v.* Laird, 2 Wheat. (U. S.) 390.

[2] State Sav. Asso. *v.* Nixon-Jones Printing Co., 25 Mo. App. 642.

[3] Hubbersty *v.* Manchester &c., R. Co., L. R. 2 Q. B. 59.

[4] Hammond *v.* Hastings, 134 U. S. 401; *s. c.* 33 L. ed. 960; 10 Sup. Ct. Rep. 727.

[5] Jennings *v.* California Bank, 79 Cal. 323; *s. c.* 12 Am. St. Rep. 145; 21 Pac. Rep. 852; 29 Cent. L. J. 150.

upon the shares of stock held by one of its members by virtue of a *by-law* merely, there is much judicial authority, based on the soundest reasoning, to the effect that it can not make good this lien against a *bona fide* transferee of the shares who had no knowledge of it; and this although the certificates which represent the shares recite that they are transferable only on the books of the company, or at the company's office by person or by attorney.[1] And so, where a stockholder died insolvent and indebted to the corporation, and subsequently the directors, by resolution, prohibited the transfer of stock by any debtor of the company until the debt should be paid or secured, and the stockholder's administratrix afterwards sold the stock to a person who was ignorant of the indebtedness and of the resolution,— it was held, that the corporation had no right to refuse to transfer the stock to the purchaser.[2] But a lien, created by by-law, is valid as against one purchasing stock at execution sale with knowledge of the by-law, if the indebtedness to the company is older than the judgment.[3] The reason of such conclusion is very plain. The policy of the law has made certificates of shares *quasi*-negotiable, assimilating them as nearly as their character will admit to negotiable instruments. A corporation should not, as against a *bona fide* purchaser for value of such a security, be allowed to assert a secret lien of which the paper itself contains no intimation. The general policy of the law is against secret liens in respect of personal property; and where the corporation establishes a by-law reserving a lien upon its shares for any debt due it by the holder of such shares, it owes a duty to the public to make known that fact by printing a notice of it on the certificates of the shares, or by other appropriate means.[4]

§ **2335. Lien for Unpaid Purchase-Money Follows Shares.**— There is a species of lien which follows the shares, on principles already stated,[5] unless the share certificates recite that they are *paid up*, or at least unless they fail to recite that

[1] Bank of Holly Springs *v.* Pinson, 58 Miss. 421; *s. c.* 38 Am. Rep. 330.

[2] Steamship Dock Co. *v.* Heron, 52 Pa. St. 280.

[3] Tuttle *v.* Walton, 1 Ga. 43. Compare Leggett *v.* Bank of Sing Sing, 24 N. Y. 283.

[4] See, *ante*, § 1680, *et seq.*

[5] See *ante*, § 1680, *et seq.*

they are *assessable*, and the transferee takes them in good faith believing that they are paid up or non-assessable: that is the lien for purchase-money due to the corporation for the shares themselves.[1] Under some schemes of incorporation this lien does not exist. Thus, in California a corporation has no special seller's lien, in the absence of a contract to that effect, on shares of its capital stock, for unpaid installments of purchase-money.[2]

§ 2336. **Effect of Statute of Limitations on Lien.** — The statute of limitations is exerted upon the remedy. It bars the action, but it does not extinguish the liability. The debt remains, although the courts will not enforce it. And where the debt is secured by lien, the lien itself is undisturbed although the action is barred; and the creditor may hold the property or enforce his demand against it by appropriate foreclosure.[3] Applying this principle to the lien of the company upon shares for debts due from the stockholder, it has been held that, though the company's right of action may be barred, the lien survives, and that the company can refuse to transfer the shares until its demand is satisfied.[4]

§ 2337. **Waiver of this Lien.** — The corporation may, on the one hand, adopt and enforce a rule restraining transfers in the assertion of its privilege of lien, or it may *waive* the privilege although conferred by its charter in express terms; and it is well held that it does waive it where, in the absence of fraud or collusion, it permits, through its proper officers, a transfer of

[1] One who acecpted and transferred his certificate of stock in a Virginia corporation, prior to an assessment made by order of the court, was not discharged from liability to be further assessed, under the Virginia Statute (Va. Code 1873, chap. 57, § 26), providing that "no stock shall be assigned on the books without the consent of the company until all the money . . . . shall have been paid, and . . . the assignee and assignor shall each be liable for any installments," etc. Morris *v.* Glenn, 87 Ala. 628; *s. c.* 7 South. Rep. 90.

[2] Lankershim Ranch &c. Co. *v.* Herberger, 82 Cal. 600; *s. c.* 23 Pac. Rep. 134.

[3] Angell Lim., §§ 73, 173; Busw. Lim., § 140.

[4] Farmers' Bank of Maryland *v.* Iglehart, 6 Gill (Md.), 50; Reading Fire Ins. &c. Co. *v.* Reading Iron Works, 137 Pa. St. 282, 298; *s. c.* 27 W. N. C. 95; 21 Pitts. L. J. (N. S.) 209; 48 Phil. Leg. Int. 108; 21 Atl. Rep. 170; Geyer *v.* Western Ins. Co., 3 Pittsb. (Pa.) 41.

shares to be made on its books with the usual formalities.[1] But where a corporation permitted a stockholder to have his stock transferred on the books, which was the only manner in which an assignment could be made, to a fictitious name, which was known to the officers of the corporation, and he afterwards caused the stock to be transferred to the plaintiff, by a person represented by him to be the holder, as security for a debt due the plaintiff from him, no money being paid on the transfer, it was held, that the lien of the corporation upon the stock, for a debt due from the stockholder, was not thereby divested.[2] The mere fact that the officers of the corporation acting for it at the time the indebtedness was created, failed to insist upon the production of the certificate of the stock which had been pledged for another debt, though not transferred on the books, will not operate as a waiver of the company in favor of a prior creditor to whom the certificate had been delivered as collateral for a previous debt.[3] Mere *ignorance* on the part of the purchaser of the fact of the existence of the lien does not destroy it, for this constitutes no waiver on the part of the corporation.[4] Nor, unless an intention to do so clearly appears, does a corporation waive its lien on stock by taking a mortgage on other property to secure the indebtedness.[5] The fact that the cashier of a bank testified that "if a party is in good standing we do not question his right to a transfer; we waive it by transferring; we don't pretend to claim the right to refuse a transfer against a shareholder in good credit," and the further fact that the stockholder was allowed a large overdraft, — do not show that the loan was made on his personal credit alone, so as to waive the lien on the stock.[6] The mere assenting to an assignment, made by a stockholder for the benefit of all his creditors, "with no other preference than is, or may be authorized by law," is not a waiver of the lien on the stock for debts due by the assignor to the cor-

[1] Hodges *v.* Planters Bank, 7 Gill & J. (Md.), 306; Hill *v.* Pine River Bank, 45 N. H. 300.

[2] Stebbins *v.* Phoenix Fire Ins. Co., 3 Paige (N. Y.), 350.

[3] Platt *v.* Birmingham Axle Co., 41 Conn. 255.

Hammond *v.* Hastings, 134 U. S. 401; *s. c.* 33 L. ed. 960; 10 Sup. Ct. Rep. 727.

Kenton Ins. Co. *v.* Bowman, 84 Ky. 430; *s. c.* 1 S. W. Rep. 717; Union Bank *v.* Laird, 2 Wheat. (U. S.) 396.

[6] Jennings *v.* Bank of California, 79 Cal. 323; *s. c.* 12 Am. St. Rep. 145; 21 Pac. Rep. 852; 29 Cent. L. J. 150.

poration;[1] nor is the giving the shareholder additional time in consideration of his allowing certain shares to be sold on default without the delay prescribed by the articles, a waiver of the lien or of the right to withhold permission to transfer, as to the remaining shares.[2]

§ 2338. Circumstances Amounting to a Waiver.— A testator bequeathed 40 shares of bank stock to his four sons, A., B., C., and D., to be equally divided between them. A. alone was a minor, and during his minority the bank, after inspection of the will, with the consent of all the legatees, permitted a transfer of thirty of such shares to a stranger. The executor assigned the remaining ten shares to A., who assigned to a stranger to whom the bank refused to permit a transfer on their books until certain notes of B., C., and D., were paid. It was held that the bank had no lien on such ten shares for the debt of B., C. and D., under the Pennsylvania statute of 1824, giving banks a lien on shares for the debts of the holders to the banks, although, at the time of the transfer of the thirty shares, it was agreed that the bank should retain its lien on the remaining ten shares for such debt of B., C., and D.[3] - - - - Where the holder and owner of a certificate of *withdrawn stock*, issued by a bank, assigned the same in good faith to another bank, the title thereto became vested absolutely in the assignee. Subsequently to such assignment, and in ignorance thereof, the former bank, discounting a note for the assignor, in the belief that he is still the owner of such stock, thereby acquired no general or specific lien on the certificate, and no equity as against the real owner.[4]

§ 2339. Giving Further Credit, after Notice of Conflicting Lien.—But where the company, after being charged with notice that a conflicting lien on the stock has accrued, gives further credit to the stockholder, it will be held to have *waived* its lien as to such subsequent credits. Thus a shareholder deposited his share certificates with a bank, as security for the balance due and to become due on his current account, and the bank gave the company notice of the deposit. The certificate stated that the shares were held subject to the articles of association. It was held that the company could not, in respect of moneys

[1] Dobbins *v.* Walton, 37 Ga. 614.

[2] Bank of Africa *v.* Salisbury Gold Min. Co. (1892), A. C. 281.

[3] Presbyterian Congregation *v.* Carlisle Bank, 5 Pa. St. 345.

[4] Callanan *v.* Edwards, 32 N. Y. 483.

which became due from the shareholder to the company after notice of the deposit with the bank, claim priority over advances by the bank made after such notice.[1] The charter of a bank provided that the capital stock should not be sold or transferred, but should be held by the original subscribers, during one year from the date of the charter, and a by-law declared the stock of each stockholder to be pledged for any sum which he should owe to the bank. Within the year, a subscriber assigned his shares, and the assignee gave notice thereof to the bank, and paid the last installment due on these shares. Afterwards and within the year, the bank lent money to such subscriber. It was held that although the assignee was not entitled to a certificate of stock in his own name, yet that the assignment was valid in equity, and that as the money was lent after notice of the assignment, the shares were not pledged for its repayment.[2]

§ **2340. May Waive Formal Assent of the Directors.**— Even where the charter required the consent of the directors to the validity of a transfer, it was held that such consent need not be obtained at a formal convocation of the board, but that if it appeared that the assent of a majority of the directors had been given and in the manner that transfers of stock were frequently made, it would be sufficient.[3] On grounds even more clear, where the restraint upon the alienation without the consent of the directors while the shareholder is indebted to the company, is imposed by a *by-law*, the necessity of obtaining such consent may be *waived* by the corporation; and it has been held that it is waived by a course of conduct establishing a usage of not bringing such cases before the board; so that a transfer without such consent, but in accordance with the usage of the company, would be good as against the company.[4]

§ **2341. Settlement with Depositor by Mistake no Waiver.**— A bank in Philadelphia received from a firm in that city, one member

[1] Bradford Banking Co. *v.* Briggs, L. R. 12 App. Cas. 29; *s. c.* 56 L. J. (Ch.) 364; 56 L. T. (N. S.), 62; 35 Week. Rep. 521.

[2] Nesmith *v.* Washington Bank, 6 Pick. (Mass.) 324.

[3] Ellison *v.* Schneider, 25 La. An. 435.

[4] Chambersburg Ins. Co. *v.* Smith, 11 Pa. St. 120.

of which was a director of the bank, two drafts, payable to their own order, and indorsed by them, payable ten days after sight, upon two houses in Virginia, to be transmitted for collection, with instructions as to the manner of presentment. The cashier indorsed the drafts, making them payable to the cashier of the Bank of Virginia, and inclosed them in a letter to that cashier, stating that "the bills are enclosed for our account." The drafts were entered in short, by the Philadelphia Bank, in the bank book of the depositors. After time sufficient, according to usage, had elapsed, the note clerk extended the drafts in the book of the bank to the depositors' credit, and at their request they were shortly afterwards extended in their book. Several months afterwards, the depositors first learned that the drafts were not paid, and the Philadelphia Bank had knowledge of that fact eighteen or nineteen days later. In the meantime, the depositors' bank book had been settled seven times. One of the depositing firm, on offering to transfer his stock in the bank, was refused permission, under a statute which provides that no stockholder indebted to the bank for a debt actually due and unpaid shall be authorized to transfer his stock, or receive a dividend, till such debt is discharged, or secured to the satisfaction of the directors. The stockholder sued the bank for this refusal to allow the transfer of his stock, the drafts not having been tendered to the firm. It was held that the plaintiff could not recover; that the bank had done its duty in relation to the draft; that the settlement of the depositors' books did not alter the rights of the parties; that the extension of the drafts, in the bank books, though equivalent to payment, yet being made by mutual mistake, was not binding; and that the refusal to permit a transfer of the stock was well warranted.[1]

§ 2342. Personal Liability of Directors for Improperly Approving Transfers. — Where the directors have power to refuse to approve transfers, for the purpose of protecting the interests of the company or its shareholders, it may be conceded on general principles and analogous holdings,[2] that they will be personally liable for misfeasance if they exercise their power corruptly, but not where they are guilty of a mere error of judgment. Thus, the articles of association of a limited company provided that no transfers of shares not fully paid up should be registered unless "approved" by the directors. A

[1] Mechanics Bank *v.* Earp, 4 Rawle (Pa.) 384. Compare Callanan *v.* Edwards, 32 N. Y. 483.

[2] *Post*, §§ 4091, 4096.

large number of shares were sold to M. at par on his paying one-fifth down, and M. subsequently transferred such shares to P., who was already a shareholder, and had recently been elected a director, the directors believing that P. was a proper person to take a transfer of the shares, and having been advised by their solicitor that there was no valid objection to the transfer. P. afterwards became bankrupt, being indebted to the company to the extent of four-fifths the par value of the shares. It was held that the directors had duly exercised their judgment upon and "approved" the transfer to P., within the meaning of the articles, and that, dishonest dealing not being charged, the approval of the transfer was not such a misfeasance or breach of trust as would render the directors liable in the winding up of the company.[1]

§ 2343. Corporation Acting in Abuse of Its Power. — Where a debt of a shareholder in respect of which the corporation asserts its lien is evidenced by a *negotiable security*, the corporation may have acquired the security under such circumstances as will operate to postpone its lien to the rights of a subsequent assignee of the shares of the debtor. Thus, where an insurance company purchased a bill of exchange payable by one of its members, and the purchase was in excess of its powers, and the object of its officers in making the purchase was, by the assertion of a banker's lien, to subject the shares of such member to the payment of the bill, — it was held such an abuse of corporate rights as would prevent the company from refusing its assent to an assignment of the shares previously made to a third person, though such an assignment was unknown to the officers of the company at the time of the purchase of the bill.[2]

§ 2344. Validity of Statutes Creating Such Liens. — A statute providing that a private corporation shall have a lien on the shares of its stockholders for any debt or liability incurred to it by a stockholder, and that, if necessary for the payment of such debt, the corporation may sell the shares after notice, is

[1] Re Faure Electric Accumulator Co., 40 Ch. Div. 141; *s. c.* 58 L. J. (Ch.) 48; 37 Week. Rep. 116.

[2] White's Bank *v.* Toledo Ins. Co., 12 Oh. St. 601.

not unconstitutional when applied to subscriptions made *prior to its passage*, as it merely enlarges the remedy for legal rights already existing, so far as the sale of stock for unpaid subscriptions is concerned.[1] But where the rights of a third party have intervened as by an assignment of the certificates a different question is presented. So, where a banking association, had not, before it obtained its charter, a lien on the stock of its shareholders, it was held, in an early case, that the lien given by the charter could not overreach a prior assignment of stock so as to preclude its transfer.[2] There is authority to the effect that the legislature may pass an act creating a lien upon the stock of a corporation *already pledged* by a shareholder to a third person, where the corporation has not been notified of the pledge; though, as the pledgee in such a case would have an equitable interest which the law ought to protect, and as the statute confiscates that interest, the validity of such a statute may well be doubted on general principles. The Connecticut act of 1871,[3] provides that shares of stock may be pledged by delivering a power of attorney for their transfer, with the certificate of the stock, to the pledgee, but that no such pledge, without an actual transfer of the stock, shall be effectual against any person but the pledgor and his executors and administrators, until a copy of the power of attorney shall have been filed with the treasurer or secretary of such corporation. Another act passed in 1875[4] provides that corporations "shall at all times have a lien upon all the stock owned by any person therein, for all the debts due to them from such person." It is held that the latter act, immediately on its going into effect, created a lien in favor of a corporation for an old indebtedness, upon stock which had previously been pledged to a third person, such pledge being merely by delivery of the certificate of the stock, and a power of attorney for its transfer, with no copy of the power of attorney filed with, or other notice to, the corpo-

[1] Tutwiler *v.* Tuscaloosa Coal &c. Co., 89 Ala. 391; *s. c.* 7 South. Rep. 398. But a by-law creating such a lien has been held void as to antecedent transfers. People *v.* Crocket, 9 Cal. 112.

[2] Neal *v.* Janney, 2 Cranch C. C. (U. S.) 188.

[3] Gen. Stat. Conn. 1875, tit. 17, ch. 1, § 9; *Id.* 1888, § 1924.

[4] Gen. Stat. Conn. 1875, tit. 17, ch. 1, § 8.

ration.[1] A further pledge of the stock was made in the same manner after the act of 1875 was passed, the certificate then delivered being one issued by the company after the passage of that act, and containing no notice of any right of lien on the part of the corporation. It was held that the corporation was still entitled to its lien upon the stock as against the pledgee.[2]

Article III. Nature of Share Certificates.

§ **2348. Nature of Share Certificates.** — In order to a fuller understanding of the manner of transferring title to corporate shares, of the rights of the transferees of such shares, and of the liability incurred by the corporation in case it admits to registration on its books illegal transfers or refuses registration in cases of legal transfers, — it is necessary to consider at some length the nature of share certificates. And, first, it is to be observed that such a certificate is merely the paper representative of an incorporeal right, and that it stands on a similar footing to that of other muniments of title.[3] It is not in itself *property*, but is merely the *symbol* or paper evidence of property. Hence, the proprietary right may exist without the certificate. Numerous cases accordingly hold that a person may acquire the rights,[4] and in-

[1] Hartford Bank *v.* Hartford Life &c. Ins. Co., 45 Conn. 22.

[2] *Ibid.*

[3] Connor *v.* Hillier, 11 Rich. L. (S. C.) 193, 195; *s. c.* 73 Am. Dec. 105.

[4] Rio Grande Cattle Co. *v.* Burns, 82 Texas 50; *s. c.* 17 S. W. Rep. 1043, 1045.

cur the liabilities[1] of a shareholder, both to the corporation and to its creditors,[2] although no certificate has in fact been issued. Corporate shares have also been classed as "securities." [3] And although they may be thus designated within the meaning of particular statutes, yet it is plain that they are not secnrities in the proper sense of the word. "Certificates of stock are not securities for money in any sense; much less are they negotiable securities. They are simply the muniments and evidence of the holder's title to a given share in the property and franchises of the corporation in which he is a member." [4] The following further observations, in the same line of thought, were made by Mr. Justice Crockett: "If a firm doing business as an ordinary partnership, issue certificates to each of its members, specifying the interests of the respective copartners, such certificates would have no intrinsic value, except as evidence of the *quantum* of interest of each copartner. The joint interest of the copartner in the property and business of the firm is the substance, of the existence of which the certificate is but the evidence. If, for example, there be three copartners, each owning an undivided interest of one-third, there is no appreciable difference between the respective interests. They are in all respects precisely similar, and each several interest is an exact duplicate of the others. The same principle is applicable to corporations. The holder of ten shares of stock stands precisely upon the same footing as any other holder of ten shares. Their interests are precisely similar, and of the same value, and each holds but an undivided interest in the common property." [5] From the principle that the certificate is not the property itself, but merely the muniment of title, it has been held that the duties, privileges and responsibilities of the holder of it cannot

[1] Agricultural Bank *v.* Burr, 24 Me. 256; Agricultural Bank *v.* Wilson, *Id.* 273.

[2] Pacific Nat. Bank *v.* Eaton, 141 U. S. 227; *s. c.* 35 L. Ed. 702; 10 Rail. & Corp. L. J. 132; 11 Sup. Ct. Rep. 984; Thayer *v.* Buller, 141 U. S. 234; *s. c.* 35 L. Ed. 711; 11 Sup. Ct. Rep. 987.

[3] Connor *v.* Hillier, 11 Rich. L. (S. C.) 193, 195; *s. c.* 73 Am. Dec. 105.

[4] Mechanics' Bank *v.* New York &c. R. Co., 13 N. Y. 626; quoted with approval in Atkins *v.* Gamble, 42 Cal. 86; *s. c.* 10 Am. Rep. 282, 290. See also Hawley *v.* Brummagim, 33 Cal. 394; Hardenbergh *v.* Bacon, 33 Cal. 356.

[5] Atkins *v.* Gamble, 42 Cal. 86; *s. c.* 10 Am. Rep. 282, 290.

be divested by the mere act of writing across the face of it the word "cancelled" and returning it to the secretary of the company.[1] As a certificate is not necessary to make one a shareholder, so the surrender of it to the company does not necessarily make the holder of it cease to be a shareholder.

§ **2349. Certificates Not in the Nature of Letters of Credit.**— It has been reasoned that certificates of shares of corporate stock are not in the nature of letters of credit. A letter of credit is defined in McCullough's Commercial Dictionary to be "a letter written by one merchant or correspondent to another, requesting him to credit the bearer with a sum of money." It is defined in Bouvier's Law Dictionary to be "an open or sealed letter from one merchant in one place directed to another in another place, requesting him, that if the person therein named or the bearer of the letter shall have occasion to buy commodities or to want monies, he will procure the same, or pass his promise, bill or other engagement for it, on the writer of the letter, undertaking that he will provide him the money for the goods, or repay him by exchange, or give him such satisfaction as he shall require." Reasoning that such a certificate is not a letter of credit within these definitions, Comstock, J., said: "Now, while it may be the effect of the stock certificate to give the holder a credit, its terms do not request, invite or guarantee it. So, the possession of property of any description, or of the evidence and muniments of title thereto, in their effect give to the possessor a credit with other men. In this sense every chose in action invites a credit in favor of him who holds it, and so do the title deeds of his real estate. Innocent parties may deal with him and be deceived. They may lend their money and lose it. Nothing more than this can be said of the certificate of the ownership of stock in a corporation. Regarded as a promissory instrument, imposing obligations to be performed by the artificial person which makes it, it is like any other chose in action, except as greater restrictions may be placed upon its transfer and sale. Regarded as a muniment of title merely, it is like any other instrument by which title is

[1] Chouteau *v.* Dean, 7 Mo. App. 210; Compare Shaeffer *v.* Ins. Co., 46 Mo. 248; *ante*, § 1511, *et seq.*

manifested. But to say that, like a letter of credit, it contains a request, express or implied, addressed to no one in particular, to deal with or advance money to the holder, or that it contains any assurance or guarantee addressed to the dealer of the safety of the transaction, is in my judgment to confound plain and long settled distinctions." [1]

§ **2350. Are a Continuing Affirmation by the Corporation of the Title and Interest of the Shareholder.**— It has often been said that a certificate of stock in a corporation, stating that a designated person is owner of a certain number of shares, transferable only on the books on the indorsement and surrender of the certificate, is a continuing affirmation of the ownership of the person named therein, and that the corporation will not transfer the stock upon its books until a surrender of the certificate, and that the owner has the power and right to transfer and sell the stock until such power and right are lawfully terminated.[2] The liabilities incurred by the corporation to the innocent transferee for value of such a certificate are elsewhere considered.[3]

§ **2351. Liability of the Corporation for Fraudulent Certificates.** — It follows that if the officers or agents of the corporation, who are by it lawfully vested with the authority to issue certificates, issue them in fraud of the rights of the corporation, and even in excess of the limit which the corporation has the power to issue, although the taker of such certificates, for value and in good faith, may not be entitled to the rights of the shareholder therein, he will be entitled to *indemnity* from the corporation for the loss which he has sustained through the imposition thus practiced upon him.[4] If the unauthorized or fraudulent issue is within the power of the corporation, the taker may be entitled to be admitted to the rights of a shareholder; but where the issue is beyond the power of the corporation, and indeed in any event, the certificate exists in his hands as a title to indem-

[1] Mechanics Bank *v.* New York &c. R. Co., 13 N. Y. 599, 630.

[2] Joslyn *v.* St. Paul Distilling Co., 44 Minn. 183; *s. c.* 3 Bkg. L. J. 320; 8 Rail. & Corp. L. J. 332; 46 N. W. Rep. 337; Kisterbock's Appeal, 127 Pa. St. 601; *s. c.* 14 Am. St. Rep. 868.

[3] *Post,* § 2595, *et seq.*

[4] *Ante,* § 1493.

nity for what he has lost through the fraud of the agent of the corporation.[1] Thus, if the treasurer of a private corporation, whose duty it is to issue certificates of the stock of the corporation, fraudulently issues certificates, regular in form, but not representing any real stock, and *pledges* them to secure money borrowed by himself, which money he uses for his own purposes, the corporation will be liable *in damages* to the pledgee who took the certificates without notice of the fraud, for the amount loaned by him to the treasurer, with interest.[2] In such a case it is said that the *measure of damages* is either the market value of the stock, at the date of the loan, with interest, or the amount of the loan with interest. The allowance, however, should not, in any case, exceed the latter sum.[3] In such a case the fact that the shares purport to be issued to the treasurer himself by whom the certificates are signed does not render them invalid,[4] although it may, under a recent holding, put the purchaser upon inquiry and take him out of the category of a *bona fide* purchaser without notice.[5] It is also evident that the *subsequent transferee* of such a fraudulent share certificate may maintain an action against the corporation for damages in case it has been fraudulently issued; since otherwise the doctrine that it is a continuing affirmation by the corporation of the title of the person named therein would be meaningless.[6] Nor is *privity of contract* necessary to support such an action, because the injured party is not seeking redress upon contract, but purely for the tortious act in the commission of which the contract is an accidental incident.[7]

§ 2352. **An Illustration.**—An illustration of the principle that a corporation becomes liable to innocent third persons for certificates of shares fraudulently issued by its transfer agent is found in a recent decision of the Supreme Court of New York, upon the following state of

[1] New York &c. R. Co. *v.* Schuyler, 34 N. Y. 30; *ante*, § 1493.

[2] Tome *v.* Parkersburg R. Co., 39 Md. 36; *s. c.* 17 Am. Rep. 540. In this case the question is considered at great length and many authorities cited. Titus *v.* Great Western Turnpike, 5 Lans. (N. Y.) 250.

[3] Tome *v.* Parkersburg R. Co., *supra*.

[4] Titus *v.* Great Western Turnpike., *supra*.

[5] *Post*, § 2606.

[6] *Ante*, § 1493.

[7] New York &c. R. Co. *v.* Schuyler, 34 N. Y. 30.

facts: F. & Co., a firm of brokers, were requested by the transfer clerk of the defendant corporation to sell 100 shares of defendant's stock standing in the name of B. The signature of defendant's president and treasurer to the certificate for the stock were genuine, and the certificate had been regularly countersigned and registered. B. was a fictitious person, and the certificate was signed after all the authorized stock of defendant had been issued and was in circulation. The transfer clerk fraudulently receipted in B.'s name for the certificate, and also signed the name of "B." on the back of the certificate, and then witnessed the signature in his own name. After ascertaining that the stock was properly registered, F. & Co. then inquired at defendant's general transfer office, and were there informed that the stock was properly indorsed for transfer, and that the person in charge was then willing to make the transfer. F. & Co., thereupon sold the stock, and, in compliance with a rule of the stock exchange known to defendant, gave a guaranty to the purchaser of the correctness of the certificate and also of the transfer. Defendant having notified the stock exchange of the invalidity of the certificate, F. & Co. were required to make good their guaranty, and did so, and received back the certificate of stock from their purchaser, and subsequently demanded the transfer of the stock from defendant, which was refused. In an action brought by the assignee of F. & Co. it was held that defendant was estopped to deny the validity of the certificate; and that plaintiff was entitled to genuine stock therefor if that were possible; but that, that being impossible, he was entitled upon defendant's repudiation of the certificate, to recover damages.[1]

§ 2353. **Stock Certificates not Negotiable.** — It is laid down in numerous cases that stock certificates are not negotiable, either in form or character,[2] though, as heretofore seen, they are often said to be *quasi*-negotiable. The general consequence of this doctrine is that whoever takes them takes them subject to the equities and burdens which attend them, as in the case of the purchase of any other non-negotiable paper, and that, although ignorant of such equities and burdens, his ignorance does not relieve the paper thereof, or enable him to hold it discharged therefrom.[3] "They contain, in the first place," said

[1] Jarvis *v.* Manhattan Beach Co., 53 Hun (N. Y.), 362; *s. c.* 25 N. Y. St. Rep. 1; 6 N. Y. Supp. 703; 6 Rail. & Corp. L. J. 325.

[2] *Post*, § 2587, *et seq.*

[3] Hammond *v.* Hastings, 134 U. S. 401; *s. c.* 33 L. ed. 960; 10 Sup. Ct. Rep. 727; Young *v.* South Tredegar Iron Co., 85 Tenn. 189; *s. c.* 4 Am. St. Rep. 752; Mechanics' Bank *v.* New York

Comstock, J., "no words of negotiability. They declare simply that the person named is entitled to certain shares of stock. They do not, like negotiable instruments, run to the bearer or to the party to whom they are given. They commence, it is true, with the words, 'Be it known,' but such words have no tendency to show that they possess the quality claimed for them. A phraseology quite similar may be found in bonds or other instruments which no one ever thought to be negotiable."[1] But it is wide of the mark to say, as is sometimes said, that they possess *none* of the qualities of negotiable paper, and hence must be treated as other personal property, the title to which can be divested only by the owner's consent or by operation of law;[2] for we shall see hereafter that a *bona fide* purchaser for value frequently gets, on the principle of *estoppel*, a better title than his vendor had to give.[3] They possess *one* of the essential qualities of negotiable paper, — that of being assignable, as between vendor and purchaser or pledgor and pledgee, by mere delivery when properly indorsed; for when indorsed in blank, by the person named therein as the owner of the shares, they pass by mere delivery, without further indorsement and without transfer on the books of the corporation, although they are not negotiable securities.[4] But they are non-negotiable in the sense that a *complete transfer of title*, good not only between the parties but also against the corporation itself, can only be made with the concurrence of the act of the corporation in pursuance of its charter, governing statute, or operative by-laws.[5]

§ 2354. Are Subject to Limitations and Burdens Created by General Laws. — Although, as hereafter seen, the corporation is *estopped* by the certificate from disaffirming the title of the person named therein, to the extent of the language employed in the certificate and the reasonable implications

&c. R. Co., 13 N. Y. 599, 623; Hawes *v.* Gas Consumer's Benefit Co., 9 N. Y. Supp. 490. See notes on this subject, 4 Am. St. Rep. 759, and 28 Cent. L. J. 404.

[1] Mechanics' Bank *v.* New York &c. R. Co., 13 N. Y. 599, 623.

[2] Weaver *v.* Barden, 3 Lans. (N. Y.) 338.

[3] *Post*, § 2593.

[4] Graves *v.* Mono Lake &c. Co., 81 Cal. 303; *s. c.* 22 Pac. Rep. 665.

[5] *Post*, § 2387, *et seq;* Hall *v.* Rose Hill &c. Co., 70 Ill. 673.

arising therefrom,[1] yet the certificate is attended with whatever burdens and infirmities are created by *general laws*, governing the corporation. If, therefore, a *public statute*, — as distinguished from a private statute — reserves to the corporation a *lien* upon its shares for debts due by the shareholders to the corporation, whoever purchases such shares takes them subject to this right of lien, although in point of fact he may be ignorant of the existence of the statute.[2] And while the *lien* of the corporation is capable of being *waived*,[3] yet the omission of the corporation to state in the share certificate that the corporation retains a lien thereon by force of the statute, is not a waiver by the corporation of this right of lien.[4]

§ **2355. Conditional Share Certificates.** — Conditional stock certificates which merely provide that upon payment for them the company will issue unconditional stock, and which do not entitle the holder to dividends, are said to involve the reservation of a *lien* on the part of the company for the amount due thereon by the holders to whom the certificates are issued. The performance of the condition by such holders, — that is, the payment for the shares according to the contract of subscription, — is a *condition precedent* which must be fulfilled before the corporation can be required to issue the unconditional certificates, or before it can rightfully do so, where it has received what are called "*stock notes*" in liquidation of the amount due by the subscribers to the conditional certificates, which notes it has transferred to *bona fide* takers for value. To illustrate this, we may refer to a recent case in Texas, where a railroad company issued what were called conditional certificates of stock in exchange for "stock notes" given by the subscribers, the condition expressed in the certificates being that when the holder should pay the stock notes according to their tenor and effect, together with the interest accruing thereon, full paid stock of the company, to the amount named in the conditional certificate, should be issued to him. The same company issued

[1] *Post*, §§ 2518, 2571, 2577, 2595.

[2] Hammond *v.* Hastings, 134 U. S. 401; *s. c.* 33 L. ed. 960; 10 Sup. Ct. Rep. 727.

[3] National Bank *v.* Watsontown Bank, 105 U. S. 217, 221.

[4] Hammond *v.* Hastings, *supra.*

another form of certificate, reciting that "the holder is not entitled to any dividend until the notes for which it is given are paid, when upon surrender hereof, an unconditional certificate will be given by the company." The "stock notes," given to the company by the subscribers in exchange for these conditional certificates were turned over by the company to contractors who had furnished labor and materials in building its road, and these contractors assigned some of them to the plaintiff, who prosecuted them to judgment against their makers, and, in order to realize his debt from them, demanded of the company the execution of a power to sell the conditional shares of the makers of the notes, which power had been given by its charter. The company refused so to do, on the ground that it had disabled itself from so doing by issuing full paid stock to the makers of the notes in exchange for the conditional stock. It was held, for the most obvious reasons, that the company was liable in damages to the holder of the notes. It was the duty of the company, after having negotiated the notes, to hold the unconditional shares in trust until the assignees of the notes were paid, and it was its duty to ascertain that the notes had been paid before issuing such unconditional stock. The court reasoned that the lien created by the company's retention of the possession of the stock was a security for the payment of the note, and that this security followed the note.[1]

§ **2356. Validity of Share Certificates.** — At the threshold of this inquiry it may be premised that there is some sort of presumption of the validity of share certificates, being perhaps an illustration of the general presumption of right-acting which obtains until the contrary is shown. Thus, it has been held in the Superior Court of Indianapolis, that where it is shown that a certificate of stock in an incorporated company was *assigned*, and that after its assignment it was surrendered to the company, and other certificates issued for the same stock, to no greater amount than the stock surrendered, in the absence of any proof to the contrary, it will be *presumed* that the stock was surrendered with the assent of those to whom it was assigned.[2]

[1] Houston &c. R. Co. *v.* Bremond, 66 Tex. 159.

[2] Smock *v.* Henderson, 1 Wilson (Ind.), 241.

Passing the point of this presumption and coming to the stage where stock is shown to have been issued in excess of the powers of the corporation, that is, where it is shown to have been an *ultra vires* issue of stock, it has already been observed that the only right acquired by the innocent taker of the share certificate is to have indemnity from the corporation to the extent of his losses.[1] Another court of subordinate authority has, however, reasoned that an *ultra vires* stock certificate may be sustained to some extent on the theory of contract. What the court is reported to have held was that a certificate issued by an educational corporation having no power to issue stock, declaring R. entitled to one share, valued at one hundred dollars, of the real property of the corporation, drawing interest at six per cent., though not operative as a certificate of stock, may be sustained as a *contract to pay annual interest*, during the term of the corporation.[2] The court also held that no *lien* was created on the real estate of the corporation by such a certificate.[3] A share certificate is not necessarily invalid because it is issued to one of the officers of the corporation by whom it is signed. When, therefore, the *treasurer* of a stock company, whose duty it was, in connection with the president, to sign certificates of stock, issued certificates to himself, apparently regular, but in fact fraudulent, the signature of the president having been negligently affixed, and disposed of them for value to the plaintiff, who took them in good faith supposing them to be genuine, — it was held that the company was liable to the plaintiff for the money advanced by him. The fact that the treasurer had signed certificates issued to himself, did not of itself render them irregular or invalid.[4] The case is not that of a person trying to make a contract with himself. The treasurer was the mere ministerial agent of the corporation and was required to authenticate the share certificates in all cases, and the contract was the contract of the corporation with him, assuming that it was free from fraud, and this infirmity did not affect an innocent purchaser. Certificates of stock are not

[1] *Ante*, § 1493.

[2] Bryant *v.* Ohio College of Dental Surgery, 1 Cinc. (Ohio) 307.

[3] *Ibid.*

[4] Titus *v.* Great Western Turnp. Road, 5 Lans. (N. Y.) 250; *s. c.* affirmed 61 N. Y. 237.

necessarily invalid because issued at a place *outside the State* in which the corporation was organized and has its principal place of business.[1] It has been held in Massachusetts that a share certificate, previously sold and transferred on the books of the corporation, may be *signed by the treasurer*, even in a case where the corporation has been *dissolved* by a decree of court and perpetually enjoined from transacting business and receivers thereof appointed, where there has been a failure to procure the signature of the treasurer before dissolution.[2] The court reasoned that the act being merely ministerial, related back to and took effect from the time of the transaction described in the records of the corporation. "The case," said Bigelow, C. J., "bears a strong analogy to that class of cases where a note or bill has been sold or delivered with an intent to transfer title, but no indorsement has been made on it until after the payee has become bankrupt, in which it has been held that the bankrupt, or his assignee, is bound to make the indorsement, and may be compelled to do so; and that, when his indorsement is made, it has relation to and takes effect from, the time of the actual sale and delivery of his bill or note."[3] The author suggests that the case also bears some analogy to the amendment by a sheriff of his return after he has gone out of office. He will be allowed, and may be compelled, to amend his return, in furtherance of justice, even after the lapse of years. It has been held that where the charter provides that the president and directors shall cause a certificate to be given to each shareholder, signed by them and countersigned by the treasurer, a certificate issued without the authority of the directors and without consideration, is void: and that since the president, in issuing such certificate, acts without the scope of his authority, the corporation are not liable for his act.[4]

§ **2357. Right to a Certificate.**— The right of a subscriber to a proper share certificate evidencing his title, depends, of

[1] Courtright *v.* Deeds, 37 Iowa, 503, 510; *ante*, § 686, *et seq.*

[2] Sewall *v.* Chamberlain, 16 Gray (Mass.), 581.

[3] *Ibid.*; citing Smith *v.* Pickering, Peake, 50; Ex parte Greening, 13 Ves. 206; Anon., 1 Camp. 492; Lampriere *v.* Pasley, 2 T. R. 485.

[4] Holbrook *v.* Fauquier &c. Turnpike Co., 3 Cranch C. C. (U. S.) 425.

course, on his performance of his contract of subscription on his part; and if *payment* is a *condition precedent* to the issuing of the certificate, until he pays he is not entitled to it. A decision in New York is to the effect that where a corporation, in a suit for the balance of a subscription for shares of the company, recovers only a portion of the sum claimed, because the other part is barred by the statute of limitations, and enforces the judgment by execution, the subscriber or his assignee, after having paid the amount recovered, is entitled to a certificate of the stock.[1] The court proceed on the ground that, even after recovering the judgment for part of what was due from the subscriber, the company might have discharged the judgment, or might have declined to enforce it; but that, by proceeding to collect it by execution, they made their *election* to take what was due on the stock subscription rather than to forfeit the stock, and were concluded by this election. It has been held in a court of first instance, that where subscriptions to stock are made, to be paid in installments, and certificates are to be issued for the several installments, the corporation is not bound to issue the certificates before getting the installments, but that a readiness and willingness to issue them at the time when payment is to be made is all that can be required of it. In an action to recover such an installment, an averment of its readiness and willingness to issue the certificates is necessary. It is reasoned that the right to enforce payment is not distinct and independent from the duty to issue and deliver the stock; and that if the subscriber can not get the stock, the payment of the installment can not be enforced. The issue of the stock and the payment therefor are to be regarded as contemporaneous acts.[2] But we must here recur to the general proposition that the certificate is not the *share;* that it is not the right nor the property, but only the *evidence* of the right to the property. Therefore a contract to deliver a certain number of shares has been held, under particular circumstances, to be fulfilled where the obligor places the obligee in a position to demand the certificate from the corporation.[3]

Johnson *v.* Albany &c. R. Co., 40 How. Pr. (N. Y.) 193.

[2] James *v.* Cincinnati &c. R. Co., 2 Disney (Oh.), 261, opinion by Gholson, J.

[3] Field *v.* Pierce, 102 Mass. 253, 261.

§ **2358. Liability of Officers for False Certificates.**— This subject is considered in a future title,[1] but it is touched upon here with reference to the question what *representations* by the officers issuing an ordinary share certificate are *implied* from its *recitals*. It has been held that officers of a corporation who sign and issue certificates of its stock in the usual form, stating upon their face that the corporation is incorporated according to the laws of a particular State, and that the stock is non-assessable, thereby represent that the stock is not spurious or invalid because of their known acts or omissions, and also that everything has been done which is necessary to make the stock rightfully exempt from further assessment; and that, if such representations are false, the officers will be liable in damages to one who has taken the certificates in good faith and for value, relying upon the representations.[2]

§ **2359. What Constitutes an Issuing.**— It has been held, on a question concerning the right to a *dividend*, that the execution of a stock certificate and placing it in the post-office addressed to the person named therein, is an issue to him of the stock as of that date, entitling him to all the rights of a stockholder.[3]

§ **2360. Certificate a Vested Right.**— One who purchases shares in a corporation and receives a certificate thereof, acquires a vested right, in such a sense that any action of the corporation, not authorized by its charter or governing statute, which impairs this right, is void as against him. It is needless to say that a corporation can not, by a *by-law*, impair the right thus vested, against his consent.[4] If, therefore, the corporation assumes, by a by-law or otherwise, to divide the shares of its stock, already sold and in the hands of lawful owners, into two classes, and to give to one class a *preference* over others in sharing in the earnings of the corporation, this act will be void, unless made good by unanimous consent. And this is so,

[1] *Post*, Ch. 83, Art. VI.

[2] Windram *v.* French, 151 Mass., 547; *s. c.* 8 L. R. A. 750; 24 N. E. Rep. 914.

[3] Jones *v.* Terre Haute &c. R. Co., 17 How. Pr. (N. Y.) 529.

[4] *Ante*, § 1019.

although the equality of rights in the shares of the company was fixed by a by-law existing at the time when the purchaser acquired his shares; for such a by-law, equally with a charter provision or that of a governing statute, enters into and forms a part of his contract.[1]

§ 2361. Effect of Issuing Certificates to the Wrong Person: Improper Division of the Shares among the Co-Adventurers. — Where parties form a mining corporation to contain a certain number of shares, and convey their mining claims to trustees who are to hold the realty for corporation purposes, and issue certificates of stock, and certificates are issued to the full extent of the shares, all such certificates are valid, though some of them are issued to the wrong persons, that is, though some get more than their proportion; and the court cannot grant relief to parties who have not received their just number of certificates, by ordering the issue of new certificates to them.[2] It seems that if, in such a case, the court can get the proper parties before it, it can equalize the holdings of the shareholders; but it cannot do this where the shares have passed into the hands of innocent purchasers for value. Those who have not received their proportion will, however, it seems, be entitled to indemnity from the corporation, not in the form of new shares, for that will be beyond the power of the corporation, but in the form of pecuniary compensation for their loss.[3]

§ 2362. Interest-bearing Certificates. — The validity of interest-bearing stock certificates is more fully considered in another relation,[4] with the conclusion that unless the charter or governing statute authorizes the issuing of such shares, they are *ultra vires* and void, — though, on principles already discussed,[5] they might, in the hands of an innocent taker, stand as a right to indemnity from the corporation for what it had obtained from him by means of them. Where the power exists to issue this

[1] Kent *v.* Quicksilver Mining Co., 78 N. Y. 159, 179. See further on this question, with special reference to the power of a corporation to increase and reduce its capital stock, *ante*, § 2076, *et seq.*

[2] Smith *v.* North American &c. Co., 1 Nev. 423.

[3] *Ibid.*

[4] *Ante*, § 2236, *et seq.*

[5] *Ante*, § 2236, *et seq.;* § 2274, *et seq.*

species of shares, a certificate issued in the ordinary form of certificates of stock, but containing a promise on the part of the corporation to pay interest thereon until the happening of a specified event, constitutes the person to whom it is issued a stockholder.[1] In such a case the corporation cannot, by a vote of the stockholders, without the individual assent of the particular holder, oblige him to receive their bond, instead of money, for the interest upon such certificate.[2] If a railway corporation have authority to issue such a certificate, they may *ratify* one which has been issued without authority. And it is sufficient evidence of such ratification that the corporation, at a regular meeting of the stockholders, passed a resolution for the payment, in their bonds, of interest on such certificate.[3]

§ 2363. When Right to Certificate not Determined by Laches. — The right of the holder of a certificate in an *unincorporated joint-stock company*, which is non-assessable and which has been recognized on the records of the company and never surrendered, is not determined by his laches until such right is repudiated by the company. The principle is that the company is, as in the case of a corporation, a *trustee* for the shareholder, and that an extinction of his rights by efflux of time cannot take place until there has been some adverse action against him on the part of the company.[4]

Article IV. Formalities: Registration.

[1] McLaughlin *v.* Detroit &c. R. Co., 8 Mich. 100.

[2] *Ibid.*

[3] *Ibid.*

[4] Kobogum *v.* Jackson Iron Co., 76 Mich. 498; *s. c.* 43 N. W. Rep. 602.

§ 2365. In General: According to Charter, or By-Laws, or Usage, or Certificate.—If the charter or governing statute prescribes in detail the mode in which transfers shall be made in order to be valid, that of course must be followed. If the charter is silent, or contains only general provisions, or remands the subject to the by-laws either in terms or by implication, and by-laws are passed prescribing the method, which by-laws do not infringe the charter or the law of the land, then that method must be followed. In the absence of by-laws, then a mode of transfer may be established by the company by usage and recited on the certificate, and a transfer in that mode will be good.[1]

§ 2366. Continued: Consent of Directors.—Under a provision in the articles of association that "any attempted transfer not approved by the directors shall be absolutely void, both at law and in equity," a transfer of the certificates by a trustee, in fraud of his trust, which had not been approved and registered by the directors, when a restraining order on behalf of the *cestuis que trustent* was served on them, was held of no effect, although made to innocent takers for value.[2]

§ 2367. By-Law Requiring Stock to be First Offered to Other Shareholders.—Where the by-laws of a corporation required that, before a sale of stock, the holder should offer it in writing, through the treasurer of the corporation, to the then

[1] It has been held that, in the absence of any by-law or other law of a corporation, regulating the mode in which its stock shall be transferred, transfers must be made in the manner prescribed by the usages of the company, or set forth in the certificates of its stock. State *v.* McIver, 2 South Car. 25; Mechanics' Banking Assn. *v.* Mariposa Co., 3 Robt. (N. Y.) 395.

[2] Moore *v.* Northwestern Bank (1891), 2 Ch. 599.

existing stockholders, who had the right of pre-emption of such stock at the selling price, the court held that, the corporation having permitted transfers of certain of its stock to be made, the inference therefrom was that the offer had been made and declined, or that the requirement had been waived.[1] The court further held that even if it appeared that such offer was neither made and declined, nor waived, the requirement being solely for the benefit of those who were stockholders at the time, none other could raise the objection.[2]

§ **2368. Blank Assignment and Power of Attorney.**— The usual share certificate contains on its back a printed assignment or indorsement and also a power of attorney in blank, like the following: "For value received I hereby assign the within named share to , and appoint my attorney to make the transfer on the books of the company." This is signed by the person to whom the shares are issued. In this manner, by the usages of business, of which the courts take judicial notice, the certificate may be passed from hand to hand indefinitely, by the person to whom the certificate is issued simply signing this indorsement and delivering the certificate with the blanks unfilled to his assignee. When it reaches the hands of some one who desires to assume the legal rights of a stockholder, so as to be entitled to vote at corporate elections and to receive dividends, he fills up the blanks, by inserting his own name as transferee, just as the holder of a promissory note indorsed in blank is entitled by the law merchant, to insert any name he pleases above the indorsement as the payee. He also inserts in the second blank the name of the attorney in fact whom he wishes to make the transfer for him on the books of the corporation.[3] This person is usually the secretary or some other officer of the company, though he may insert the name of whomsoever he pleases.[4] The attorney so appointed does ex-

[1] American Nat. Bank *v.* Oriental Mills, 17 R. I. 551; *s. c.* Index. JJ. 74; 11 Rail. & Corp. L. J. 206; 23 Atl. Rep. 795.

[2] *Ibid.*

[3] Kortright *v.* Buffalo Com. Bank, 20 Wend. (N. Y.) 91; 22 *Id.* 348; *s. c.* 34 Am. Dec. 317.

[4] Dunn *v.* Commercial Bank of Buffalo, 11 Barb. (N. Y.) 580. It is held in this case that the possession of the certificate with a blank assignment, and

actly what the original shareholder would have done had he gone to the company's office to make the transfer of the shares to his vendee: he makes an entry on the book kept by the company for that purpose, usually the stock ledger, to the effect that the shares have been transferred to the new purchaser. Then the certificate is surrendered, as hereafter indicated,[1] and a *new certificate* is issued to the transferee.

§ **2369. Attestation: Two Witnesses.** — A by-law requiring the attestation of the cashier or two other witnesses to the signature of the holder of a certificate has been held valid; and where the by-law read "*in the presence* of the cashier or two other witnesses," this was held to require that the cashier or two other witnesses should, in writing, attest the signature of the holder.[2]

§ **2370. Assignment Need not be Under Seal.** — An assignment of shares in a corporation need not be under seal.[3]

§ **2371. When Transfer Made by Officer of the Corporation and not by Assignor.** — As elsewhere seen,[4] the transfer is ordinarily made on the books of the corporation, either by the owner of the shares in whose name they stand on the books, or by his attorney appointed for that purpose. He or his lawful attorney, and not some one else, is the proper person to pass the legal title to his own property; yet we find one case holding that where the charter of a corporation provides that the

power of attorney, is no evidence of title, but this is a judicial hallucination; all the cases hold or imply the contrary. Where the owner of shares *assigned them to two persons*, and gave a power of attorney to *one* of them to transfer them on the books of the bank, the power was held to be valid, whether the power authorized the transfer to be made to both assignees, or to the attorney alone; and the bank was held not to be liable for refusing to transfer the shares to a subsequent attaching creditor, who sold them on execution. Plymouth *v.* Bank of Norfolk, 10 Pick. (Mass.) 454.

[1] *Post*, § 2377.

[2] Dane *v.* Young, 61 Me. 160.

[3] Atkinson *v.* Atkinson, 8 Allen (Mass.), 15. But in England if the corporation undertakes to give a certificate of the title of a shareholder, to enable him to effect a transfer of his shares to a new purchaser, this is held to be a representation of the credit and validity of the transfer within the meaning of § 6, of Lord Tenterden's Act, and is invalid if not under seal, and *ultra vires*. Bishop *v.* Balkis Consol. Co., 25 Q. B. Div. 77.

[4] *Post*, § 2368.

shares of the corporation shall be transferable in the manner prescribed by the by-laws, and it is not shown that any by-laws have been adopted, but the certificate of stock provides that the stock is transferable only on the books of the company on the surrender of the certificate, the *officers of the company*, and not the assignor of the stock, should transfer the stock on the books.[1]

§ 2372. **What Officer.** — Where a corporation has no secretary or clerk, and the *president* has charge of the stock books, a demand on the latter to make the necessary transfer of stock to a purchaser of outstanding shares is sufficient.[2]

§ 2373. **Shares in Names of Executors: Joint Transfer.** — When, under the English Companies Clauses Act of 1845, § 18, the names of the executors of a deceased shareholder in a company are placed on the register of shareholders in respect of shares which belonged to their testator, they become joint shareholders in their individual capacity, although they may be described as executors in the register, and consequently the shares can only be transferred by means of a transfer *executed by all of them.*[3]

§ 2374. **Transfer Made on What Book: Stock Ledger, Subscription List.** — Though the by-laws of a corporation require the entry of transfers of shares on a stock ledger, yet if none is kept, and a transfer by the subscriber to the capital stock to another is entered, according to the custom of the company on the *subscription list*, and an assignment is indorsed on the shares themselves, and a new certificate is issued to the purchaser by the company, the latter cannot deny the validity of the transfer.[4] So, a provision in a by-law and in corporate stock certificates, that they shall be transferable only on the company's transfer books, is waived where no regular transfer books are ever furnished and the transfers are registered on the certificate book, which, with memoranda on its marginal stubs, answers the purpose of a transfer book and a stock ledger as

[1] Green Mount &c. Turnpike Co. *v.* Bulla, 45 Ind. 1.

[2] Green Mount &c. Turnpike Co. *v.* Bulla, 45 Ind. 1.

[3] Barton *v.* London &c. R. Co., 24 Q. B. Div. 77.

[4] Stewart *v.* Walla Walla Print. &c. Co. 1 Wash. 521; *s. c.* 20 Pac. Rep. 605.

well as of a certificate book.[1] And even where the requirement of a general statute was that transfers, to be valid as to third persons, must be "regularly entered on the books of the company,"[2] it has been held that a simple entry in a stock book that certain stock has been assigned as collateral security is sufficient to protect the assignee from the claims of the assignor's judgment creditors.[3] A transfer may be valid and effectual as between the parties, without any registration at the office of the company, and will be binding upon all parties, if noted by the company according to their usual method, no transfer books being kept by them.[4]

§ 2375. **Transfer Book or Stock Ledger as Evidence.** — On principle, the transfer book or stock ledger of the corporation is evidence against those who are in privity with it, and against such persons only.[5] For instance, the transfer book is admissible to show the date of a transfer where that is material.[6] It has been held that, as between a corporation and a corporator, the stock book is *primary*, and the certificate *secondary* evidence of their relation.[7] The appropriate evidence of the stockholder's right to vote *at corporate elections* by incorporated companies includes the stock ledger, as well as the certificate book and transfer book, but the ledger is evidence only as subordinate to, and as supported by the other books. In case of dispute the transfer book must control the rest.[8] Where the directors are deprived of the possession of the stock book, it is proper for them to open a new one, making it a copy, as far as possible, of the old. In such a case, the inspectors of an election may properly refer to the *new stock-book* to ascertain who are voters; but if the old book be produced, the record therein must

[1] American Nat. Bank *v.* Oriental Mills. 17 R. I. — Index JJ. 74; *s. c.* 11 Rail. & Corp. L. J. 206; 23 Atl. Rep. 795.

[2] Code Iowa, § 1628 (1078).

[3] Moore *v.* Marshalltown &c. Co., 81 Iowa, 45; *s. c.* 46 N. W. Rep. 750.

[4] Haegele *v.* Western Stove Co., 29 Mo. App. 487.

[5] *Ante*, § 1919; *Contra*, Hoagland *v.* Bell, 36 Barb. (N. Y.) 57. Compare Pinkerton *v.* Manchester &c. R. Co., 42 N. H. 424.

[6] Kraft *v.* Coykendall, 7 N. Y. Supp. 140; *s. c.* 26 N. Y. St. Rep. 79.

[7] Bank of Commerce's Appeal, 73 Pa. St. 59.

[8] Downing *v.* Potts, 23 N. J. L. 66.

govern in reference to transfers recorded there before the new book was opened.[1]

§ 2376. **What is a Sufficient Register.**— Where the act incorporating a turnpike company provided that the shares of stock should be transferable only on the books of the company, in such manner as the company should, by their by-laws, direct; and a by-law of the company provided that the board of directors should prescribe the form of transfer to be registered by the clerk on the books of the company, and that no transfer should be valid unless so made and registered,— a written assignment of stock, made *in pais*, in the form prescribed by such by-law, and seasonably *registered at length* by the clerk on the books of the company, was a transfer on the books of the company, within the meaning of the charter, and conveyed the legal title to the shares.[2] A statute of Alabama provides that transfers of corporate stock shall not be valid as against *bona fide* creditors and subsequent purchasers without notice, "except from the time such transfer shall have been registered or made upon the book or books of such company." A corporation kept only a single book of stock certificates with a stub attached to each, on which were entered the date, name, number, etc., corresponding with each certificate issued. A memorandum entered on the stub, thus: "Transf. to A., assignee, for collateral, Dec. 1, 1884," was held to be a substantial compliance with the statute so as to charge with notice a subsequent creditor or purchaser.[3] A corporate by-law required the consent of the directors to a transfer of stock to be made on the books of the company, and to be attested by the secretary. A stockholder empowered the secretary, in writing, to transfer certain stock, in pursuance of which, the secretary entered on the books that the stock was transferred, "see paper filed," which paper filed, being the power, he wafered to the book, and attested the entry of transfer as secretary, but signed no trans-

[1] Schoharie Valley R. Co.'s Case, 12 Abb. Pr. (N. S.) (N. Y.) 394.

[2] Northrop *v.* Carter, 5 Conn. 246. Compare Richmondville Man. Co. *v.* Prall, 9 Conn. 487; Bridgeport Bank *v.* N. Y. &c. R. Co., 30 Conn. 231.

[3] Fisher *v.* Jones, 82 Ala. 117; *s. c.* 19 Am. & Eng. Corp. Cas. 450; 3 South. Rep. 13; 2 Rail. & Corp. L. J. 535.

fer as attorney of the stockholder. It was held that this was a substantial compliance with the by-law.[1] When the stock ledger of a bank shows the name of the proprietor, the date of the transfer, the number of shares transferred, the name of the transferor, and the value of the shares, it is a sufficient "entry in the books of the bank," within the statute of Maine.[2] Under the Kansas statute requiring stock to "be transferred only on the books of the corporation, in such manner as the by-laws may prescribe," in a case in which the company had failed to provide by by-law for the regulation of transfers, it was held, that the corporation had kept a sufficient record, under the statute, by making a memorandum of the transfer in a stock book on the stub of the old certificate, with a reference to the number of the new certificate issued in its place, where the stubs contained a memorandum of the date of issue, number of the certificate, number of shares, and the name of the person to whom it was issued, and a new certificate was always issued when a transfer was made; and that a stockholder, who had sold his stock and permitted his name to remain on the company's books as a stockholder, could not avoid individual liability for corporate debts on the ground that no by-law prescribing the manner of transfer had been enacted.[3]

§ 2377. Issue of New Certificates Unnecessary but Usual. — We have seen that a stock certificate is only *evidence* of the title of the shareholder, and is not necessary to constitute him such.[4] For the same reason it is not necessary that the transferee should obtain a *new certificate*, which is but additional evidence of his title; he becomes legally entitled to *the shares* when they are formally transferred to him on the company's books without the issue of a new certificate.[5] A consequence of this principle

[1] Chambersburg Ins. Co. *v.* Smith, 11 Pa. St. 120.

[2] Rev. Stat. 1840, ch. 76, § 12; Skowhegan Bank *v.* Cutler, 52 Me. 509.

[3] Plumb *v.* Bank of Enterprise, 48 Kan. 484; *s. c.* 29 Pac. Rep. 699.

[4] *Ante*, § 1140.

[5] Agricultural Bank *v.* Burr, 24 Me. 256; Same *v.* Wilson, *Id.* 273; Chouteau Spring Co., *v.* Harris, 20 Mo. 382; Haegele *v.* Western Stove Co., 29 Mo. App. 486, 492; Davenport Bank *v.* Gifford, 47 Iowa, 575. The record of transfers of stock upon the books of a bank was held sufficient, as between the assignee and the bank, to work a change of ownership, without new certificates: Keyser *v.* Hitz, 133 U. S.

is that if A. transfers his shares to B., and the transfer is duly registered on the books of the company, but no new certificate is issued to B., and A. thereafter undertakes to transfer the same shares to C., and the company does issue a new certificate to C., C. thereby gets no title to the shares; the certificate not being the shares themselves, but a mere evidentiary paper.[1] For a similar reason, if the transferor retains the certificate in his own possession, this will not prevent the legal title from passing to the transferee by way of gift, although he may have no knowledge of the transfer.[2] But while the new certificate is not necessary to the title of the transferee, it is an important muniment of his title, without which his shares would become practically non-vendible. He may therefore have the aid of equity to compel the corporation to issue it to him.[3]

§ 2378. **Surrender of the Old Certificate not Strictly Necessary.** — By parity of reasoning it may be concluded that a surrender of the old certificate is not necessary to the passing of a good title to corporate shares, though the corporation, for its own protection, will always insist upon this being done. A transfer of stock upon the books of the company to a *bona fide* holder for value, carries the title to the stock, although the certificate previously issued is not surrendered at the time of the transfer.[4] The rules of the company as to the mode of making transfers of its stock, requiring a surrender of the certificate,

138, 149; *s. c.* 3 L. ed. 531. Cf. New York &c. R. Co. *v.* Schuyler, 34 N. Y. 30; Pacific Nat. Bank. *v.* Eaton, 141 U. S. 227; *s. c.* 35 L. ed. 702; 10 Rail. & Corp. L. J. 132; 11 Sup. Ct. Rep. 984; Thayer *v.* Butler, 141 U. S. 234; *s. c.* L. ed. 711; 11 Sup. Ct. Rep. 987.

[1] Houston &c. R. Co. *v.* Van Alstyne, 56 Tex. 439.

[2] Thus T. transferred two thousand shares of stock to F., a niece of his wife, — on the books of the corporation, but retained the certificates in his possession; and, after his death, they were found in an envelope, with his own name and that of F. indorsed thereon. F. had no knowledge of the transfer; she lived in the family of T., and was, in all respects, treated and regarded as his daughter. It was held that the transfer on the books of the corporation vested in F. the legal title. Robert's Appeal, 85 Pa. St. 84. Compare, *post*, §§ 2390, 2399.

[3] National Bank *v.* Watsontown Bank, 105 U. S. 217; *post*, § 2425, *et seq.*

[4] New York &c. R. Co. *v.* Schuyler, 38 Barb. (N. Y.) 534; *s. c.* aff'd, 34 N. Y. 30. See also Moores *v.* Citizen's Nat. Bank, 111 U. S. 156, 167. Compare Bond *v.* Mount Hope Iron Co., 99 Mass. 505; *s. c.* 99 Am. Dec. 49.

while they may be insisted upon by the company, cannot be allowed to have the effect of impairing the rights of third persons who are ignorant of them.[1] The corporation must require the surrender of the old certificate at his own peril.[2] The certificate being a *continuing affirmation* by the corporation that the person therein named is entitled to the number of shares therein named of its capital stock, it is evident that the corporation, by allowing the transfer to be made on its books while the certificate is outstanding, may put it in the power of any one into whose hands it may fall to injure an innocent third person by transferring it to him for value. Such a taker of the certificate could not be admitted to the rights of a shareholder, but he would have an action for damages against the company.[3]

§ 2379. Old Certificate must be Properly Indorsed. — If the corporation takes up the old certificate when it is not properly indorsed and cancels it and makes the transfer on its books to the new transferee, it does so at the peril of having to answer in damages to the real owner of the shares for their conversion in case the transferee had no right to have the transfer made to him.[4]

§ 2380. Change of Title when "Received for Record." — Where a *by-law* of a corporation provided that no transfer of shares should be of any avail until *received for record* by the clerk, who should enter thereon the time he received it, which should bear date accordingly, it was held that a sale or pledge, accompanied by a letter of attorney to make the transfer, conveyed no title until the transfer was received for record by the clerk. The change of title, in such cases, takes place when the transfer is received for record, and the transfer bears date from that time.[5]

§ 2381. National Banks: Transfer on the Books Necessary. The title to and ownership of stock in a national bank can only pass by a transfer on the books of the bank.[6]

[1] *Ibid.*

[2] Supply Ditch Co. *v.* Elliott, 10 Colo. 327; *s. c.* 3 Am. St. Rep. 587.

[3] *Ante*, § 2046.

[4] Tafft *v.* Presidio R. Co., 84 Cal. 131; *s. c.* 18 Am. St. Rep. 166; 22 Pac. Rep. 485.

[5] Oxford Turnpike *v.* Bunnell, 6 Conn. 552.

[6] Koons *v.* Jeffersonville Bank, 89 Ind. 178; Weyer *v.* Second National Bank, 57 Ind. 198; Nat. Bank Act (June 3, 1864), § 12; Rev. St. U. S. § 5139.

§ 2382. Transfer under a General Assignment for Creditors.— The legal title to stock held in corporations situated in Louisiana does not pass, under a general assignment of property, until the transfer is completed in the mode pointed out by the laws of Louisiana regulating such corporations. But the equitable title will pass if the assignment be sufficient to transfer it by the laws of the State in which the assignor resides; and if the laws of the State in which the corporation exists do not prohibit the assignment of equitable interests in stock, such an assignment will bind all persons having *notice* of it.[1]

§ 2383. [Kentucky.] Record not Constructive Notice. — A conveyance of shares in a corporation is not within the *recording acts*, and a record does not charge with constructive notice.[2]

§ 2384. When the Transfer must be by Deed. — Many of the English statutes and articles of association provide that transfers of shares can only be made *by deed.* Where a statute required the conveyance of shares to be by writing duly stamped and under the hands and seals of both parties, and afterwards called such writing a "deed or conveyance," and in another place a "deed of sale or transfer," — it was held that such a conveyance must be by deed; and, accordingly, that an instrument purporting to transfer shares in the company, executed by the proprietor of such shares, with the name of the purchaser in blank, and handed over by him to the plaintiff, by whom, on the same sale of such shares to the defendant, the defendant's name was inserted, as the purchaser, was void.[3]

ARTICLE V. UNREGISTERED TRANSFERS.

[1] Black v. Zacharie, 3 How. (U. S.) 483.

[2] Spaulding v. Paine, 81 Ky. 416.

[3] Hibblewhite v. McMorine, 6 Mees. & W. 198; re-affirmed in Société Générale v. Walker, 11 App. Cas. 29.

§ **2387. Corporation Looks Only to Its Books.**— The general rule is that a corporation looks only to its books for the purpose of ascertaining who are its shareholders and entitled to the rights of such. Only those whose names are registered on its books as shareholders are entitled to vote at its elections,[1] to receive dividends,[2] and otherwise to exercise the rights of members. It has also been held, that holders of corporate stock, not enrolled as such on the company's books, are not entitled to petition for a dissolution of a mining or manufacturing corporation, under the Ohio statute, for failure to pay the annual dividend of 6 per cent. upon paid-up capital stock.[3] The pledgee of stock, holding by the assignment of the certificates simply, will not be granted an injunction to restrain the corporation from holding a meeting, for the purpose of increasing the corporate debts, and to restrain the assignors from voting on the stock at such meeting, where it is not shown that the proposed increase of indebtedness is *ultra vires*.[4] But while it is sometimes said that a transfer of stock in a corporation, not entered on the books of the company in accordance with its by-laws, is not binding on the corporation, either with or without notice *aliunde* of the transfer;[5] yet this,

[1] *Ante*, § 730.

[2] *Ante*, § 2180. A. assigned to B. a stock certificate, containing a statement that stock was transferable only upon the books of the corporation. B. failed to obtain such transfer. A. died. It was held that the corporation, having paid *dividends* to A.'s administrator, could not be held liable to B. for their amount, no presentation of a certificate being necessary upon a demand for dividends by the owner of record of the stock or his personal representative. Brisbane *v.* Delaware &c. R. Co., 25 Hun (N. Y.), 438; to the same effect Smith *v.* American Coal Co., 7 Lans. (N. Y.) 317.

[3] Armstrong *v.* Herancourt Brew. Co. (Ohio C. P.) 26 Ohio L. J. 39.

[4] Becher *v.* Wells Flouring Mill Co., 1 McCrary (U. S.), 62; *s. c.* 1 Fed. Rep. 276.

[5] Stockwell *v.* St. Louis Mercantile Ins. Co., 9 Mo. App. 133; citing Wag.

like other general judicial statements, must be restrained by considering the relation in which the language is used. Unless superior equities arise in favor of the corporation, or in favor of third persons resisting the transfer, formally made as between the parties and good as between them, it is binding on the corporation in the sense that it will be bound, on the demand of the transferee, to record his title, that is, to note a transfer of the shares to him on its books.[1]

§ 2388. **But May Recognize the Holders of Unregistered Certificates.** — Hence, it has been well said that "a corporation is ordinarily justified in treating the assignee and holder of certificates of stock as the legal and equitable owner thereof." [2] And so where transfers of stock were not sufficient to pass the legal title, and the transferees, having paid full value, took only an equitable interest, the fact that notice of a stockholders' meeting, which authorized a general assignment for the benefit of creditors, was given to such transferees, and not to the former stockholders, in whom the legal title still remained, was held insufficient to render the action of the meeting void.[3] The rule that the company, acting in good faith and without notice of the rights of others, may treat registered stockholders as the actual owners of the shares standing in their names, has been limited in its application to such transactions as are within the express or implied powers conferred upon the company or its shareholders collectively. Thus, it was held that assignees of shares of corporate stock having possession of the certificates, though holding under unregistered transfers, are not bound by a subsequent contract between the corporation and the other shareholders, including the assignor in whose name the shares remain registered, to surrender a portion of such stock without a consideration, in order that new stock may be issued to pay corporate debts, on which ten per cent. per annum is to be paid, or as much thereof as can be paid from the net profits.[4]

Mo. Stat. 289, § 1; White *v.* Salisbury, 33 Mo. 150; Fine *v.* Hornsby, 2 Mo. App. 61; A. Wight Co. *v.* Steinkemeyer, 6 Mo. App. 574.

[1] *Post*, § 551;

[2] Supply Ditch Co. *v.* Elliott, 10 Colo. 327; *s. c.* 3 Am. St. Rep. 586, 592; citing Lanier *v.* Bank, 11 Wall. (U. S.) 369.

[3] American National Bank *v.* Oriental Mills, 17 R. I. 551; *s. c.* 23 Atl. Rep. 795.

[4] Campbell *v.* Am. Zylonite Co., 122

§ 2389. Unregistered Transfers Good as between the Parties to Them. — Another very general statement of doctrine is that unregistered transfers of corporate shares, that is, transfers which have not been made on the books of the corporation or which have not been otherwise made in conformity with its rules or by-laws, are good, as between the parties to them,— that is that they pass to the assignee all the interest of the assignor, or at least all the interest that the parties intended should pass; although they may not be good as against the corporation itself, or, more generally speaking, against third parties.[1] It has even been held that a provision of the governing statute, declaring that no transfer of stock shall be valid for any purpose until it shall have been entered in the prescribed book, in accordance with the required formalities, must be limited in its application to the objects sought by the statute, which are the security and ease of remedy of the creditors, and the information of stock-

N. Y. 455; *s. c.* 11 L. R. A. 596; 34 N. Y. St. Rep. 38; 25 N. E. Rep. 853; Rev'g 23 Jones & S. 562.

[1] Gilbert *v.* Manchester Iron Man. Co., 11 Wend. (N. Y.) 627; Quiner *v.* Marblehead Social Ins. Co., 10 Mass. 476; Sargent *v.* Essex Marine Railway, 9 Pick. (Mass.) 204; Chambersburg Ins. Co. *v.* Smith, 11 Pa. St. 120; Chouteau Spring Co. *v.* Harris, 20 Mo. 382; St. Louis Perpetual Ins. Co. *v.* Goodfellow, 9 Mo. 149; Union Bank *v.* Laird, 2 Wheat. (U. S.) 390; Bank of Utica *v.* Smalley, 2 Cow. (N. Y.) 770; *s. c.* 14 Am. Dec. 526; Sargent *v.* Franklin Ins. Co., 8 Pick. (Mass.) 90; *s. c.* 19 Am. Dec. 306; Baldwin *v.* Canfield, 26 Minn. 43; Rogers *v.* New Jersey Ins. Co., 8 N. J. Eq. 167; Haegele *v.* Western Stove Man. Co., 29 Mo. App. 486; Weston *v.* Bear River &c. Co., 5 Cal. 186; *s. c.* 63 Am. Dec. 117; Bruce *v.* Smith, 44 Ind. 5; Broadway Bank *v.* McElrath, 13 N. J. Eq. 27; Mount Holly &c. Turnp. Co. *v.* Ferree, 17 N. J. Eq. 119; Pittsburgh &c. R. Co. *v.* Clarke, 29 Pa. St. 151; Hoppin *v.* Buffum, 9 R. I. 513; *s. c.* 11 Am. Rep. 291; United States *v.* Cutts, 1 Sumn. (U. S.) 149; Duke *v.* Cahawba Nav. Co., 10 Ala. 82; *s. c.* 44 Am. Dec. 472; Commercial Bank *v.* Kortright, 22 Wend. (N. Y.), 348; *s. c.* 34 Am. Dec. 317; Johnston *v.* Laflin, 103 U. S. 800; Black *v.* Zacharie, 3 How. (U. S.) 513; Comeau *v.* Guild Farm Oil Co., 3 Daly (N. Y.), 220; Leitch *v.* Wells, 48 N. Y. 585, 592; Burrall *v.* Bushwick R. Co., 75 N. Y. 211, 219; Mechanics' Bank *v.* New York &c. R. Co., 13 N. Y. 599, 624. Compare State *v.* Harris, 3 Ark. 570; *s. c.* 36 Am. Dec. 460. See also Nesmith *v.* Washington Bank, 6 Pick. (Mass.) 324; Leavitt *v.* Fisher, 4 Duer (N. Y.), 1; Beardsley *v.* Beardsley, 138 U. S. 262; *s. c.* 34 L. ed. 928; 11 Sup. Ct. Rep. 318. And where certificates of stock are transferred by indorsement in blank, and not on the books of the company, an offer to redeliver the certificates is a sufficient tender thereof by the transferee, on a rescission of the sale. Hill *v.* Wilson, 88 Cal. 92; *s. c.* 25 Pac. Rep. 1105.

holders and creditors; that, as between vendor and vendee, the validity of the assignment as in reality made, is not affected although the stock is not transferred in legal form.[1]

§ 2390. **Sufficient to Execute a Gift.** — A gift differs from a contract in that it has no consideration to support it.[2] It is therefore essential to the validity of a gift that it should be *executed;* and the gift of a chattel can be executed only by *delivery* of the subject of the gift, or, where it is incapable of manual delivery, by a delivery of the symbol which represents it. When therefore the subject of the gift is a chose in action, which is incapable of manual delivery, the gift, in order to be effectual, must be evidenced by a delivery of the paper symbol, representative, or evidence of title to the thing which is held by the donor. This is made clear in an opinion of the Supreme Court of the United States by Mr. Justice Matthews, where it is said: "The instrument or document must be the evidence of a subsisting obligation and be delivered to the donee, so as to vest him with an equitable title to the fund it represents, and to divest the donor of all present control and dominion over it, absolutely and irrevocably, in case of a gift *inter vivos*, but upon the recognized conditions subsequent in case of a gift *mortis causá*."[3] In conformity with this doctrine, it has been often held that a valid gift of *non-negotiable securities* may be made by the delivery of them to the donee, without an assignment or indorsement in writing. This principle has been applied to notes, bonds, stocks, certificates of deposit, and life insurance policies.[4] Shares of stock, as elsewhere seen, are regarded for many purposes as *choses in action*, and the certificates as evidence of the title of the holder to them.[5] It has therefore been

[1] Johnson *v.* Underhill, 52 N. Y. 203.

[2] Kehr *v.* Smith, 20 Wall. (U. S.) 34, per Davis, J.; Gray *v.* Barton, 55 N. Y. 72, per Grover, J.

[3] Basket *v.* Hassul, 117 U. S. 602, 614. In this case the authorities on the subject of gifts of choses in action are examined at length.

[4] Com. *v.* Crompton, 137 Pa. St. 138; citing in illustration Wells *v.* Tucker, 3 Binn. (Pa.) 366; Licey *v.* Licey, 7 Pa. St. 251; Madeira's Appeal, 4 Atl. Rep. 908. In a late case the Supreme Court of Pennsylvania refused to extend this principle to the gift of a *depositor's bank book*, the delivery of which was regarded as insufficient to pass title to the accounts appearing in it. Walsh's Appeal, 122 Pa. St. 117; *s. c.* 15 Atl. Rep. 470.

[5] Slaymaker *v.* Bank, 10 Pa. St. 373.

held that a stockholder may clothe another with a complete equitable title to his shares by a *delivery* to him *of the share certificate*, without a compliance with the forms required by the corporation for a transfer of the shares.[1] It was therefore held, in the case of a gift of corporate shares, evidenced by a delivery of the share certificates, made in recognition of services for which the donor had promised to pay, accompanied by the statement that the certificates could be of no use to her after the donor was gone, was valid as against a proceeding of the State to escheat the shares, although there had been no valid written transfer.[2] So, also, it has been held that a valid gift (in view of death) of corporate stocks, may be made by simple delivery of the certificates, with intent to transfer the stock; even though the certificates on their face are made "transferable only by her or his attorney, on surrender of this certificate;"[3] though, as already seen,[4] a gift of shares may be executed by a transfer on the books without a delivery of the certificate.

§ 2391. And Pass Both the Legal and Equitable Title.—Some of the decisions assert that the delivery of the certificate, with an assignment and blank power of attorney indorsed, passes, as between the owner and the assignee, the entire *legal and equitable title* in the stock, subject only to such liens or claims as the corporation may have upon it.[5] Stated more largely, the doctrine is "that, as between the parties, the delivery of the certificate with assignment and power indorsed, passes the entire title, legal and equitable, in the share, notwithstanding that by

[1] Com. *v.* Crompton (Pa.) 137 Pa. St. 138; 48 Phila. Leg. Int. 26; 20 Atl. Rep. 417; citing United States *v.* Vaughan, 3 Binn. (Pa.) 394; Com. *v.* Watmough, 6 Whart. (Pa.) 117; Association *v.* Sendmeyer, 50 Pa. St. 67; Finney's Appeal, 59 Pa. St. 398; Water Supply Co. *v.* Kitchenman, 108 Pa. St. 630.

[2] Com. *v.* Crompton, *supra.*

[3] Walsh *v.* Sexton, 55 Barb. (N.Y.) 251.

[4] *Ante*, § 2377.

[5] McNeil *v.* Tenth Nat. Bank, 46 N. Y. 331; *s. c.* 7 Am. Rep. 341; New York &c. R. Co. *v.* Schuyler, 34 N.Y. 30, 80; Bank of Utica *v.* Smalley, 2 Cow. (N. Y.) 770; *s. c.* 14 Am. Dec. 526; Gilbert *v.* Manchester Co., 11 Wend. (N. Y.) 627; Commercial Bank *v.* Kortright, 22 Wend. (N. Y.) 348; *s. c.* 34 Am. Dec. 317; Hill *v.* Newichawanick Co., 48 How. Pr. (N. Y.) 427; Leitch *v.* Wells, 48 N. Y. 585; Comeau *v.* Guild Farm Oil Co., 3 Daly (N. Y.), 218; Boatman's Ins. &c. Co. *v.* Able, 48 Mo. 136; Carroll *v.* Mullanphy Sav. Bank, 8 Mo. App. 249; St. Louis Stoneware Co. *v.* Partridge, 8 Mo. App. 579.

the terms of the charter or by-laws of the corporation, the stock is declared to be transferable only on its books; that such provisions are intended solely for the protection of the corporation, and can be waived or asserted at its pleasure, and that no effect is given to them except for the protection of the corporation; that they do not incapacitate the shareholder from parting with his interest, and that his assignment not on the books, passes the entire legal title to the stock, subject only to such liens or claims as the corporation may have upon it, and excepting the right of voting at elections;" etc.[1]

§ 2392. Theory that only an Equitable Title Passes.— Beyond all question, the doctrine of the preceding paragraph is indisputable in the sense that such a transfer of the certificate as there spoken of operates to pass, in favor of the assignee and against the assignor, all the interest in the shares which the assignor intended to pass and could pass. In that sense the *legal title* passes. Other cases say that a transfer of shares not perfected on the company's books passes only an *equitable title*.[2] In line with this theory an unrecorded assignment of shares is sometimes called an equitable assignment.[3] And it is often said with reference to cases where the governing statute provides that the stock of the corporation shall be assignable *only* on the books of the company, that an assignment, not entered on the books of the company in conformity with the statute, will not pass the legal title, though it may pass an equitable title.[4]

[1] Rapallo, J., in McNeil *v.* Tenth National Bank, 46 N. Y. 325; *s. c.* 7 Am. Rep. 341. It was held in Stebbins *v.* Phœnix Ins. Co., 3 Paige (N. Y.), 350, that, by a transfer not on the books, the transferee acquired only an equitable right to or lien on the shares, and that, having but an equitable right or lien, he took subject to all prior equities, which existed in favor of the company against the person from whom such assignment was obtained. And Chancellor Walworth, in his dissenting opinion in Commercial Bank *v.* Kortright, 22 Wend. (N. Y.) 348, *s. c.* 34 Am. Dec. 317, strenuously maintained the same doctrine. Such seems to have been the principle administered in Rogers *v.* New Jersey Ins. Co., 8 N. J. Eq. 167. But the contrary became settled in New York, as seen by the preceding cases.

[2] Bank of Commerce's Appeal, 73 Pa. St. 59; Bruce *v.* Smith, 44 Ind. 1; Lippitt *v.* American Wood Paper Co., 15 R. I. 141; *s. c.* 2 Am. St. Rep. 886; 23 Atl. Rep. 111.

[3] Fraser *v.* Charleston, 11 S. C. 486.

[4] Lippitt *v.* American Wood Paper Co, 15 R. I. 141; *s. c.* 2 Am. St. Rep. 886. See also Fisher *v.* Essex Bank, 5 Gray (Mass.), 373; Blanchard

§ **2393. Meaning of this Expression.** — The distinction between the legal and equitable ownership of personal property must be more or less shadowy, and it is believed that the courts which say that, in the case supposed in the two preceding paragraphs, the legal title passes, and those which say that only an equitable title passes, do not differ much in their real meaning. The difference between the legal and equitable ownership of corporate shares is analogous to the difference between the legal and equitable ownership of *land*. Roughly speaking, the legal owner of land is the one who owns it by deed, whereas the equitable owner is the one who, being the real owner, has no deed, but must invoke the aid of a court of equity, as against the legal owner, to get a deed. So, the legal owner of shares in a corporation is the owner in whose name the shares stand on the books of the corporation, whereas the equitable owner is the one who, being the beneficiary, that is the real owner, is not registered as such on the corporate books, and who must, if the corporation refuses so to register him, go into a court of equity to compel them to do so.[1] The real meaning is that his title is complete as against everybody but the corporation itself, and those who have a superior right to have the corporation make the transfer to them.[2]

Dedham Gaslight Co., 12 Gray (Mass.), 213; Marlborough Man. Co. *v.* Smith, 2 Conn. 579; Northrop *v.* Newton &c. Tp. Co., 3 Conn. 544; Shipman *v.* Ætna Ins. Co., 29 Conn. 245; Naglee *v.* Pacific Wharf Co., 20 Cal. 529; Williams *v.* Mechanics' Bank, 5 Blatchf. (U. S.) 59; Brown *v.* Adams, 5 Biss. (U. S.) 181; Broadway Bank *v.* McElrath, 13 N. J. Eq. 24; Black *v.* Zacharie, 3 How. (U. S.) 483; Otis *v.* Gardner, 105 Ill. 436; Farmers' Nat. Gold Bank *v.* Wilson, 58 Cal. 600; Application of Murphy, 51 Wis. 519; Union Bank *v.* Laird, 2 Wheat. (U. S.) 390; Pittsburgh &c. R. Co. *v.* Clarke, 29 Pa. St. 146; State Insurance Co. *v.* Sax, 2 Tenn. Ch. 507. These cases all sustain the statement in the text that an assignment by delivery will not pass a legal title, though it may pass an equitable title; but they vary as to the rights of an attaching creditor.

[1] *Post*, § 2495.

[2] The courts do not intend to exclude this larger meaning when they say loosely that an unrecorded transfer of shares is good as against everybody *but the corporation*. This expression is generally used in cases where the corporation is resisting the transfer as being in derogation of its own rights, and where the courts are not thinking of the rights of creditors and subsequent purchasers without notice. Thus, according to the official syllabus of a case in Georgia the title of a purchaser of stock in a railroad company is complete against everybody but the corporation, when the seller has given, on the scrip, authority to the

§ **2394. Contract to Sell: Assignment of Certificate.** — The general rule being that, in order to pass the full legal title, the assignment must be made on the books of the company, it is therefore held that a contract to sell and deliver shares of stock is satisfied by transferring the shares to the vendee upon the books of the company without delivering the certificate of stock to him, the certificate being merely additional evidence of title.[1] On the other hand, it is a recognized rule in the sale of such shares, that an assignment of the stock certificate will not, of itself, pass the title to the shares, although like an agreement in writing to sell land, it gives an equity, so that the assignee of the certificate can compel a transfer upon the books, except as against a *bona fide* purchaser who has acquired a title by such transfer.[2] It follows that the purchaser of such shares may insist that the certificate shall be delivered up to him; and where the corporation itself is the purchaser, it may insist that the certificate shall be delivered up for cancellation. Yet where this is not insisted upon at the time of the transaction, the purchaser is not at liberty to refuse payment on the ground that he has not received a transfer of title. The outstanding certificate might be evidence of an equity in the hands of a *bona fide* holder, and might give the purchaser trouble; but he should protect himself by requiring its surrender to him at the time of the sale.[3]

§ **2395. Unregistered Transfers Estop the Transferor.** — Proceeding another step, it is clear that, in the absence of fraud

proper officer to transfer upon the books, and the purchaser has paid the price; and there is at least a *prima facie* presumption that the price is paid when the authority to transfer is given, and the possession of the scrip is delivered. Ross *v.* Southwestern R. Co., 53 Ga. 514. Again, it has been said that transfers of stock in a corporation, which have not been entered on the books of the company, as provided by statute, are, nevertheless, valid as against all the world, except subsequent purchasers in good faith without notice. Parrott *v.* Byers, 40 Cal. 614.

[1] White *v.* Salisbury, 33 Mo. 150. See Agricultural Bank *v.* Burr, 24 Me. 256, 263; Ellis *v.* Essex Merrimac Bridge Co., 2 Pick. (Mass.) 243; Chester Glass Co. *v.* Dewey, 16 Mass. 94; *s. c.* 8 Am. Dec. 128.

[2] Boatman's Ins. & Trust Co. *v.* Able, 48 Mo. 136, 139. See Sargent *v.* Franklin Ins. Co., 8 Pick. (Mass.) 90; *s. c.* 19 Am. Dec. 306; Sargent *v.* Essex &c. Co., 9 Pick. (Mass). 202; Commercial Bank *v.* Kortright, 22 Wend. (N. Y.) 348; *s. c.* 34 Am. Dec. 317; Chouteau Spring Co. *v.* Harris, 20 Mo. 382.

[3] Boatmen's Ins. & Trust Co. *v.* Able, 48 Mo. 136.

or other equitable circumstances, a transfer of corporate shares, though not made on the company's books in conformity with its rules, estops the transferor and is good as against him. A party who sells corporate stock and receives a consideration therefor, and gives a power of attorney for its transfer, will not be allowed, in equity, to defeat the rights of parties acquired under the transfer, solely upon the ground of the legal insufficiency of the instruments by which it was effected.[1] In a case in the English Chancery Division it is reasoned that when certificates of stock, having on the back blank forms of transfer and of power of attorney to surrender and cancel the certificates, duly signed by the registered holders, are transferred, each prior holder confers on the *bona fide* holder for value of the certificates, for the time being, authority to fill in the name of the transferee, and is estopped from denying such authority, and to this extent, but no further, is estopped from denying the title of such holder for the time being. By such delivery an inchoate legal title passes, but a title by unregistered transfer is not equivalent to the legal estate in the shares, or to the complete dominion over them.[2] It has been laid down in New York that "a blank transfer of a certificate of stock, with irrevocable power of attorney to transfer, signed by the person who appears by the certificate to be the owner, * * * confers upon the holder of the certificate and power of attorney, the apparent legal and equitable title to the stock; and that a *bona fide* purchaser of such stock from such holder can hold the stock against the real owner, who is estopped from asserting his title."[3] This class of cases is not to be confounded with the case stated in a future section[4] where the owner has lost possession of his certificate without fault on his part. They rest on the principle that the real owner, having by contract conferred on the holder all the external indicia of title, and an apparently unlimited power of disposition over the stock, "is estopped to assert his title against a third person, who, acting in good faith, acquires it

[1] Chew *v.* Bank of Baltimore, 14 Md. 299.

[2] Colonial Bank *v.* Hepworth, 36 Ch. Div. 36; *s. c.* 56 L. J. (Ch.) 1089; 57 L. T. (N. S.) 148.

[3] Merchants Bank *v.* Livingston, 74 N. Y. 226. An analysis of the New York cases will be found in Pom. Rem., §§ 160, 161.

[4] *Post*, § 2516.

for value from the apparent owner."[1] This rule has been placed upon the principle that where one of two innocent parties must suffer through the fraud of a third the loss must rather fall on the one who by placing trust and confidence in the third has enabled him to commit the fraud.[2] But it is not sound to place it upon this principle, because this principle would apply to a horse or any other chattel as well as to a certificate of corporate stock; so that if the owner of a horse should hire or lend him to a third person, who should take him out of his sight and then sell him to an innocent purchaser, the owner, by the operation of this principle, would lose his title. The view can rest upon no other doctrine than that which favors the extension of certain incidents of negotiability to this kind of paper.[3]

§ 2396. And His Privies — as His Assignee in Bankruptcy. — Clearly such a transfer will also estop the privies of the transferor, unless their equities are such as to enable them to assert a *higher title* than he had, under principles hereafter stated.[4] Following the principle that a transfer of shares of corporate stock is good between the transferor and his transferee, and hence binding upon the *privies* of the transferor, although not made on the books of the corporation, as provided by its charter, it has been held that where the director of a national bank transferred certain stock owned by him in the bank to a third person, as collateral security for his note, and afterwards went into bankruptcy, and thereafter the pledgee of the stock sold it on notice to him and to his assignee, and the bank refused to transfer the shares to the purchaser, — the purchaser had a right of action against the bank for a conversion. The transfer of the shares in pledge, with the execution of the customary power of attorney, gave to the pledgee a power coupled with an interest which was not revoked by the bankruptcy of the pledgor and which could only be revoked

[1] 2 Dan. Neg. Inst., 3rd ed., § 1708 g; McNeil *v.* Bank, 46 N. Y. 325; *s. c.* 7 Am. Rep. 341; Mount Holly Turnpike Co. *v.* Ferree, 17 N. J. Eq. 117; Prall *v.* Tilt, 28 N. J. Eq. 479.

[2] East Birmingham Land Co. *v.* Dennis, 85 Ala. 565; *s. c.* 28 Cent. L. J. 402; citing Allen *v.* Maury, 66 Ala. 10 (which related to *warehouse receipts*).

[3] See further of the rights of *bona fide* purchasers, *post*, §§ 2593, 2636.

[4] *Post*, §§ 2593, 2636.

by the payment of the debt. The assignee under the bankrupt act, except as to property conveyed for the purpose of defrauding creditors, and in violation of the provisions of the act, took only such estate as the bankrupt had, and consequently acquired no right to the shares higher than that which the bankrupt had.[1]

§ 2397. Unregistered Transfers not Valid against Third Parties without Notice.—Another view which receives much support in reason and authority is that, where the governing statute requires the transfer to be made on the books of the company, a transfer of shares of corporate stock not registered on the books of the corporation, is not valid *as against third persons* who have not actual notice of the transfer. These decisions proceed on the larger view that the object of such a statute is not merely the protection of the corporation itself, but the protection of the public; that it is in the nature of a *recording act*, and that the books of the corporation furnish a registry to which any person intending to deal in respect of the shares may look for information as to their real ownership.[2] It should be constantly borne in mind that the question is liable to turn upon the reading of particular local statutes, and perhaps the different readings of such statutes account for the differences of judicial opinion upon this question.[3]

§ 2398. Danger of Failing to Obtain a Transfer.— "By omitting to register his transfer, the holder of the certificate and

[1] Dickinson *v.* Central Nat. Bank, 129 Mass. 279; *s. c.* 37 Am. Rep. 351. See also Continental National Bank *v.* Elliott Nat. Bank, 7 Fed. Rep. 369, learned opinion by Lowell, J.

[2] This conclusion is affirmed, and this view of such statutes is expressed with more or less directness, in the following cases: Weston *v.* Bear River &c. Co., 5 Cal. 186; *s. c.* 63 Am. Dec. 117; *s. c.* on second appeal, 6 Cal. 425, 429; Parrott *v.* Byers, 40 Cal. 625; People *v.* Elmore, 35 Cal. 655; Strout *v.* Natoma &c. Co., 9 Cal. 78; Naglee *v.* Pacific Wharf Co., 20 Cal. 533; Application of Murphy, 51 Wis. 525. Compare Pendergast *v.* Bank of Stockton, 2 Sawy. (U. S.) 116. The California cases are made to rest on the peculiar language of the statute: "No transfer * * * shall be valid for any purpose * * * except to render the 'transferee liable for corporate debts' until it shall be entered as required by the provisions of this section." This was copied from the Wisconsin statute, which in its turn came from Maine. Skowhegan Bank *v.* Cutler, 49 Me. 315.

[3] For opposing views on this question with reference to creditors, see the next article, *post*, § 2409, *et seq.*

power fails to obtain the right to vote, and may lose his stock by a fraudulent transfer on the books of the company, by the registered holder, to a *bona fide* purchaser. But, in this respect, he is in a condition analogous to that of the holder of an unrecorded deed of land, and possesses a no less perfect title as against the assignor and others. And he would have an action against the corporation for allowing such a transfer in violation of his rights. He also takes the risk of the collection of dividends by his assignor, or of any lien the corporation may have on the shares. But in other respects his title is complete."[1]

§ 2399. Illustration. — Transfer of stock on the books of an incorporated company is merely to pass it to the transferee. It is as good between the parties, if made without consideration, as if made with it. It does not profess to disclose the consideration which induced it, nor the terms of the contract from which it emanates and of which it is the consummation.[2]

§ 2400. Not Good against Subsequent Purchaser in Good Faith without Notice. — Another consequence of the same doctrine is that an unregistered transfer is not good as against a subsequent purchaser of the shares from the transferor without actual notice of the transfer.[3] The rule under discussion does not, under the circumstances named, exact inquiry outside of or behind the register,[4] the principle being that *bona fide* purchasers of stock, without notice, are at liberty to act upon the faith of the title being where upon the books of the bank it appears to be.[5]

§ 2401. Otherwise as to Purchaser at Judicial Sale with Notice. — But it has been ruled that, if such shares are seized under an *attachment* against the transferor and sold, a *purchaser* at the sale who has notice of the transfer, will not get a good title.[6]

[1] Rapallo, J., in McNeil *v.* Tenth Nat. Bank, 46 N. Y. 325; *s. c.* 7 Am. Rep. 341, 345. As to the necessity of recording transfers, see a learned article by Chief Justice Corliss, 39 Alb. L. J. 164, 184.

[2] Hall *v.* United States Ins. Co., 5 Gill (Md.), 484. See as to a *gift*, *ante*, § 2377.

[3] People *v.* Elmore, 35 Cal. 655; Naglee *v.* Pacific Wharf Co., 20 Cal. 533; New York &c. R. Co. *v.* Schuyler, 38 Barb. (N. Y.) 534.

[4] Cady *v.* Potter, 55 Barb. (N. Y.) 463; Williams *v.* Fletcher, 129 Ill. 356; *s. c.* 21 N. East. Rep. 783.

[5] Sabin *v.* Bank of Woodstock, 21 Vt. 353.

[6] Weston *v.* Bear River &c. Co., 6 Cal. 429. See *post*, § 2409, *et seq.*

§ 2402. Transfer in Blank is a Symbolical Delivery. — In Kentucky it is held that where, by the charter, stock is assignable by transfer on the books of the corporation, the assignment of the certificate, with a written power to the assignee to transfer the stock to himself on the books, is a *symbolical delivery*, affecting those who have notice thereof as if the transfer had been made on the books.[1]

§ 2403. Sale of Shares and Subsequent Sale of Interest Due thereon. — However much a share certificate may resemble negotiable paper in its incidents, no such resemblance can be discovered in any other supposed debt due by the corporation. Thus, if one sells his shares, he cannot afterwards sell to another his right to any *interest* due by the corporation in respect of the shares; for this has passed with the sale of the shares, and the purchaser of the interest gets nothing, as his vendor had nothing to sell. Such a purchaser cannot, therefore, maintain an action against the corporation for such interest.[2] But, no doubt, any interest due in respect of preferred shares, or any dividend declared and not paid may be separately transferred, with the concurrence of the holder of the shares and the corporation, saving of course the rights of innocent purchasers of the shares.[3]

§ 2404. Decisions under Particular Statutes. — Previously to the payment of the first installment, a subscriber for stock in the State Bank of Indiana, possessed no right transferable under the charter of the bank; and, after such payment, the stock acquired by such payment could only be disposed of by assignment on the books of the bank. It was *payment* and not *subscription* that made the stock.[4] - - - - The provision of the Dakota Civil Code, that a transfer of stock must, in order to be valid against third parties, be entered on the corporation books (Sec. 398), applies only to the transfer of legal title, and not to an equitable interest in the stock, secured by a pledge of the stock; and such an equitable transfer will prevail against creditors attaching the stock with knowledge of the prior assignment.[5]

[1] Bank of America *v.* McNeil, 10 Bush (Ky.), 54.

[2] Manning *v.* Quicksilver Mining Co., 24 Hun (N. Y.), 360.

[3] A dividend declared but not paid would not pass with the shares even in favor of an innocent purchaser: *ante*, § 2175.

[4] Colman *v.* Spencer, 5 Blackf. (Ind.) 197.

[5] Van Cise *v.* Merchants' Nat. Bank, 33 N. W. Rep. 897; 2 Rail. & Corp. L. J. 295.

§ 2405. Decisions on Special Transactions. — Where stock, for the transfer of which the owner had delivered a power of attorney in blank, authorizing its transfer, but only for a special purpose, which having been accomplished, was afterwards transferred again and held as collateral security for a promissory note of the attorney in fact, indorsed by a third party, and the holder released the indorser for the purpose of making him a witness in a proceeding in equity for its recovery, at the suit of the original owner of the stock, — it was held that the stock, even if rightfully held, was released by this act, without the consent of the owner, and could not be held even for the purpose of enforcing payment of the note.[1] - - - - S., in 1855, agreed to transfer to G. thirty shares of insurance stock, to secure G. for certain liabilities assumed by him, and delivered to him a certificate for the stock, and a power of attorney to transfer it. G. held these without making any transfer on the books of the company, where alone a legal transfer could be made, and without giving notice to the company, until August, 1857, when the insurance company having made a dividend in stock, which required a change of certificate, S. procured the certificate from G., for the purpose of exchanging it, and promised to transfer the stock to him on the books of the company, and bring him a certificate in his own name for the same. S. failed to make the transfer and to deliver the certificate, and in January, 1858, went into insolvency. The court held that G. had no lien upon the stock which was valid against the trustee in insolvency.[2] - - - - S. in 1851, assigned to H. in writing, to secure him for a liability assumed for S., fifteen shares of insurance stock, standing on the books of the insurance company in the name of Y., and delivered to him the certificate for the same in Y.'s name. This certificate H. delivered up to S., at his request, in 1854, to enable him to avail himself of a stock dividend then made, upon his promise to transfer the shares to H. on the books of the company, and to procure and deliver to him a certificate in his own name therefor. S. failed to make the transfer and to procure the certificate, and H., under the belief that it had been done, made no demand upon S., and gave no notice to the company. In January, 1858, S. went into insolvency. It was held that H. had no lien on the stock which was valid against the trustee in insolvency.[3]

[1] Denny *v.* Lyon, 38 Pa. St. 98; *s.c.* 80 Am. Dec. 463.

[2] Shipman *v.* Ætna Ins. Co., 29 Conn. 245.

[3] Shipman *v.* Ætna Ins. Co., 29 Conn. 245.

Article VI. Priorities as Between Attaching Creditors and Unrecorded Transferees.

§ 2409. Unregistered Transfer not Good as against Creditors of the Assignor. — A doctrine already stated,[1] is that an unregistered assignment of corporate shares is not good as against an *attaching creditor* of the assignor.[2] The courts which take this view, resting their conclusion in some cases on

[1] *Ante*, § 2397 . See also *post*, § 2591.

[2] Weston *v.* Bear River &c. Co., 5 Cal. 186; *s. c.* 63 Am. Dec. 117; Skowegan Bank *v.* Cutler, 49 Me. 315; Fort Madison Lumber Co. *v.* Batavian Bank, 71 Iowa, 270; *s. c.* 32 N. W. Rep. 336; 60 Am. Rep. 787; Commercial Nat. Bank *v.* Farmers' &c. Bank, 82 Iowa, 192; *s. c.* 47 N. W. Rep. 1080; Dutton *v.* Connecticut Bank, 13 Conn. 493, 498; Shipman *v.* Ætna Ins. Co., 29 Conn. 245, 253; Johnson *v.* Laflin, 103 U. S. 804; Blanchard *v.* Dedham Gas Light Co., 12 Gray (Mass.), 213; Fisher *v.* Essex Bank, 5 Gray (Mass), 373; Pinkerton *v.* Manchester &c. R. Co., 42 N. H. 424; Buttrick *v.* Nashua, &c. R. Co., 62 N. H. 413; *s. c.* 13 Am. St. Rep. 578; Noble *v.* Turner, 69 Md. 519; *s. c.* 18 Md. L. J. 808; 16 Atl. Rep. 124; Berney Nat. Bank *v.* Pinckard, 87 Ala. 577; *s. c.* 6 South. Rep. 364; Re Murphy, 51 Wis. 519; *s. c.* 8 N. W. Rep. 419; Abels *v.* Planters &c. Ins. Co., 92 Ala. 382; *s. c.* 20 Ins. L. J. 848; 9 South. Rep. 423; Fisk *v.* Carr, 20 Me. 301; People's Bank *v.* Gridley, 91 Ill. 457; Northrop *v.* Turnpike Co., 3 Conn. 544; Naglee *v.* Wharf Co., 20 Cal. 530; Conway *v.* John, 14 Colo. 30; *s. c.* 23 Pac. Rep. 170. Compare Boston Music &c. Assn. *v.* Cory, 129 Mass. 435; Scripture *v.* Francestown Soapstone Co., 50 N. H. 571, 855, 589.

express statutory enactments,[1] in some cases on the implications arising from statutes requiring transfers to be recorded on the books of the corporation,[2] and in still others on legal analogies,[3]— hold that the rights of the attaching creditor prevail over those of the prior unregistered transferee.

§ 2410. Unless the Attaching Creditor has Actual Notice of the Transfer. — But this rule does not obtain where the attaching or execution creditor has actual knowledge or notice of the prior unrecorded transfer.[4]

§ 2411. Reasons in Support of This View. — This conclusion is supported by the analogy of the rule which avoids transfers of tangible personal property as against creditors, in cases where there has been no *visible change of possession*, such as the circumstances reasonably admit of. Thus, Adams, C. J., speaking for the court, says: "Stock in an incorporated company is personal property. Transfers of personal property, to be valid as against attaching creditors, should be attended by a visible change of possession, or else evidence of the transfer should be spread upon a public record. We have an express provision of statute for property where a visible change of possession can be made. In the case of stock in an incorporated company, no visible change of possession can be made. Stock is a share in the interests and rights of the corporation. Certificates are mere evidence. They may never be issued. It is not essential that they should be. When issued, they are merely for convenience. The object of the imperative provision that transfers of stock shall be recorded unquestionably is that the ownership may be made apparent." The court, therefore, held that the statute of

[1] Newell *v.* Williston, 138 Mass. 240; Re Murphy, 51 Wis. 519; Conway *v.* John, 14 Colo. 30; *s. c.* 23 Pac. Rep. 170; Fort Madison Lumber Co. *v.* Batavian Bank, 71 Iowa, 270; *s. c.* 60 Am. Rep. 789; 32 N. W. Rep. 336; Ryan *v.* Campbell, 71 Iowa, 760; *s. c.* 32 N. W. Rep. 340; Naglee *v.* Pacific Wharf Co., 20 Cal. 529.

[2] Central Bank *v.* Williston, 138 Mass. 244; Fisher *v.* Essex Bank, 5 Gray (Mass.), 378.

[3] Reasoning in Fort Madison Lumber Co. *v.* Batavian Bank, *supra*. See next section.

[4] Bridgewater Iron Co. *v.* Lissberger, 116 U. S. 8; Farmers' Gold Bank *v.* Wilson, 58 Cal. 600; Scripture *v.* Francestown Soapstone Co., 50 N. H. 571.

that State[1] providing that "the transfer of shares is not valid, except as between the parties thereto, until it is regularly entered on the books of the company, so as to show the name of the person by and to whom transferred, the number or other designation of shares, and the date of the transfer," — was intended in part for the protection of creditors.[2] These and other like decisions also proceed upon that clause in corporate charters or governing statutes which provides that the shares of the corporation shall be *transferred on the books*, or *only on the books*, of the corporation. Their policy was thus expressed by Waite, J., in a case in Connecticut: "An attaching creditor is not bound to look beyond the books of a corporation to ascertain whether his debtor has made any assignment of the stock standing in his name. The books of the corporation are the appropriate place to determine the ownership of its stock."[3] But this view, which makes the stock and transfer books *public records*, open to the inspection of the public, is plainly untenable unless the statute law (as it does in some States) obliges the corporation to expose such records to the inspection of the public. Otherwise they are strictly private records, sustaining no analogy to the records of transfers of title required to be made and kept in public recording offices; and even these last records import no notice except in those cases where the statute law expressly so provides.

§ 2412. View that Unrecorded Transfers Prevail over Subsequent Attaching or Execution Creditors of the Transferor.— There is a difference of judicial opinion upon the question whether an unrecorded transfer of stock, made to a taker for value in the mode already pointed out, will prevail over a subsequent attaching or execution creditor, or one purchasing at a sale under a subsequent attachment or execution. One class of cases holds that, in the absence of a statute which, in express terms or by reasonable implication, makes a transfer on the books of the corporation necessary as against third persons — in other words,

[1] Code Ia., ed. 1880, § 1078; ed. 1888, § 1628.

[2] Fort Madison Lumber Co. *v.* Batavian Bank, 71 Ia. 270; *s. c.* 60 Am. Rep. 789; 32 N. W. Rep. 336.

[3] Dutton *v.* Connecticut Bank, 13 Conn. 493, 498. Compare Johnston *v.* Laflin, 103 U. S. 800, 804.

makes it analogous to the recording of a deed under a recording act, — such a transfer will be good as against subsequent attaching and execution creditors and those claiming through them.[1] These cases proceed upon the view that an attaching creditor gets no higher rights, by levying on shares standing on the books of the corporation in the name of his debtor, than his debtor has in them at the time of the levy. This view has been taken, even where the governing statute declared the stock of the corporation personal property and "transferable on the books," and that "books of transfer of the stock should be kept, and should be evidence of the ownership of said stock in all elections," etc., by the stockholders.[2] This view of course prevails in those jurisdictions where an unrecorded transfer is held to pass the *legal title* as between the transferor and transferee;[3] and where a complete legal title, under this theory has thus passed, it must follow that the service of an attachment against the transferor on the officers of the company will hold nothing,— unless the theory prevails in the particular jurisdiction that any *equities* which may remain in the assignor are leviable.[4] A statute declaring that transfers of corporate stock shall not be valid, except as between the parties thereto, until regularly entered upon the corporate books, has been held not to have been intended for the protection of the creditors of shareholders; and the conclusion was that a transfer might be valid against such creditors, notwithstanding the statute, although not entered upon the corporate books.[5] This is in accordance with the theory that such statutory restraints upon transfers are intended only for the protection of the corporation.[6] In Minnesota such a ruling has been expressly put upon that ground.[7] In Louisiana

[1] Clark *v.* German Security Bank, 61 Miss. 611; Seeligson *v.* Brown, 61 Tex. 114; Broadway Bank *v.* McElrath, 13 N. J. Eq. 24; Cornick *v.* Richards, 3 Lea (Tenn.), 1; Bank *v.* Richards, 6 Mo. App. 454; *s. c.* aff'd, 74 Mo. 77; Wilson *v.* St. Louis &c. R. Co., 108 Mo. 588; *s. c.* 32 Am. St. Rep. 624; Beckwith *v.* Burrough, 13 R. I. 294; Hazard *v.* Exchange Bank, 26 Fed. Rep. 94; Comean *v.* Guild Farm Oil Co., 3 Daly (N. Y.), 219.

[2] Broadway Bank *v.* McElrath, 13 N. J. Eq. 24.

[3] *Ante*, § 2391.

[4] As to which see *post*, § 2774.

[5] Thurber *v.* Crump, 86 Ky. 408; *s.c.* 6 S.W. Rep. 145; 3 Rail. & Corp. L. J. 149.

[6] *Ante*, § 2387, *et seq.*

[7] Lund *v.* Wheaton Roller Mill Co., 50 Minn. 36; *s. c.* 36 Am. St. Rep. 623. Compare Joslyn *v.* St. Paul Distilling Co., 44 Minn. 183; *s. c.* 46 N. W. Rep. 337; 8 Rail. & Corp. L. J. 332; Bald-

in order to the perfection of a *bona fide* sale and delivery of stock as against the vendor's creditors, if coupled with a power of attorney to the buyer to transfer on the books, it is not necessary that *notice* of the sale be served on the corporation, or an actual transfer be made on its books.[1] In Missouri, it has been held that, in the absence of a legislative enactment restricting the transfer of stock to any particular mode, the transfer is complete on delivery of the certificate with power to transfer and payment of the purchase money, not only between vendor and vendee, but, when the corporation has unjustifiably refused to make the transfer on its books, against a creditor of the vendor, who, without notice of the transfer, attaches the stock. "The plaintiff," said the court, "had done all that lay in his power to perfect his title by transferring on the books of the defendant before any attachment was levied; the defendant by an unjustifiable refusal to make the transfer could not defeat the rights of plaintiff to the stock, nor give the attaching creditor any advantage, which it would never do had the defendant done his duty and made the transfer to the holder of the stock upon its books."[2] A similar ruling was made by the Supreme Court of Pennsylvania in a case where the officers of the company had notice of the assignment as soon as it was made, though there was no transfer on the books.[3] Under this view it has been held that, inasmuch as a sale and assignment of shares of the capital stock of a corporation, attended by a delivery of the certificate, vests in the buyer the title to the stock, notwithstanding a provision contained in the certificate that the stock was transferable only upon the books of the company, it follows that the service of the attachment against the assignor by the sheriff on the officers of the company, after such assignment, vests no equity in the sheriff; the company cannot refuse, on the ground of such attachment, to make a transfer on its books to the vendee; and that for such a refusal, the company is hence liable to the vendee for the value of the stock.[4]

win *v.* Canfield, 26 Minn. 43; *s. c.* 1 N. W. Rep. 261.

[1] Smith *v.* Crescent City &c. Slaughter House Co., 30 La. An. 1378.

[2] Merchants' Bank *v.* Richards, 6 Mo. App. 454; *s. c.* aff'd, 74 Mo. 77.

[3] Telford &c. Turnp. Co. *v.* Gerhab, 21 Am. & Eng. Corp. Cas. 471; *s. c.* 13 Atl. Rep. 90; 3 Rail. & Corp. L. J. 439

[4] Comeau *v.* Guild Farm Oil Co., 3 Daly (N. Y.), 218.

§ 2413. Some Holdings under this View.—Where this view is taken, a by-law providing that stock can only be transferred on surrender of the certificate to the president or secretary, who shall write "cancelled" thereon before issuing a new certificate, is regarded as having been intended merely to protect the interests of the corporation. A delivery of a certificate by A. to B., without transfer on the books, as collateral security, with A.'s name signed thereon to a blank transfer, is valid against C., an attachment creditor of A.; and on garnishment thereof the court may order the shares to be sold, and the proceeds paid first to B., to the extent of his debts and the overplus, if any, to be applied to C.'s judgment.[1] - - - - In another case B. transferred, on the books of a corporation, his shares to G. as collateral security. Afterwards, the necessity for the security being at an end, G., at B.'s request, indorsed and transferred the certificate to D., a creditor of B. Before any record of this transfer had been made on the corporation books, another creditor of B. attached the shares as B.'s property. It was held that the attachment could not be maintained.[2] - - - - Another court holds that, in the absence of a legislative enactment restricting the transfer of stock to any particular mode, the transfer is complete on delivery of the certificate with power to transfer, and payment of the purchase money, not only between vendor and vendee, but when the corporation has unjustifiably refused to make the transfer on its books, against a creditor of the vendor, who, without notice of the transfer, attaches the stock.[3] So, it has been held that the unrecorded transferee of shares has no *lien* on them, which can prevail against a *trustee* of the shareholder *in insolvency*, where he becomes insolvent subsequent to the transfer; and it makes no difference that he is a transferee for value.[4] Under a *statute of Alabama*[5] shares which the purchaser fails to have transferred within fifteen days after the purchase are liable to attachment at the suit of any creditor of the person in whose name the stock stood on the books, and an attaching creditor who perfects his lien upon stock by recovering a judgment is a *bona fide* creditor from the inception of his lien.[6]

§ 2414. Rights of Attaching Creditor Paramount to Those of Subsequent Purchaser Without Notice.— Generally, though not always, priority in time gives priority of right.

[1] Seeligson *v.* Brown, 61 Tex. 114.

[2] Beckwith *v.* Burrough, 13 R. I. 294.

[3] Merchants Nat. Bank *v.* Richards, 74 Mo. 77; affirming *s. c.* 6 Mo. App. 454.

[4] Shipman *v.* Ætna Ins. Co., 29 Conn. 245.

[5] Ala. Code 1876, §§ 2041, 2043, 2044.

[6] Berney Nat. Bank *v.* Pinckard, 87 Ala. 577; *s. c.* 6 South. Rep. 364.

Shares of corporate stock are not negotiable instruments, though they partake to some extent of the qualities of such instruments.[1] Therefore, as a general rule, a purchaser of such shares gets no higher title or interest than his vendor has to convey. From these premises it follows that where shares are levied upon by attachment, the attaching creditor acquires a right superior to that of a subsequent *bona fide* purchaser of such shares for value without notice of the attachment.[2] And this is so, even where the corporation is a *foreign corporation*, provided there is a statute, such as now frequently enacted subjecting foreign corporations doing business within the State to the operation of the statutes governing domestic corporations. Thus, in the case of a foreign corporation doing business in Tennessee, where there was such a statute, the stock of one of its shareholders, himself a non-resident of Tennessee, was attached in that State for a debt. The stock certificates were in his possession in the State of his residence. After the attachment, he sold them to a *bona fide* purchaser for value, who had no notice of the attachment, and transferred to such purchaser the certificates. It was nevertheless held that the rights of the plaintiff in attachment were paramount to those of such purchaser.[3] Somewhat in the same line of legal thought, it has been held that after one's shares of stock have been attached, and the corporation served with notice, a transfer to a creditor of more shares than are necessary to secure his debt, for which there has been an equitable hypothecation, cannot be made as against the attaching creditor.[4]

§ 2415. Distinction Between Statute and By-law Provision Requiring Transfer on Corporate Books.— A distinction has been taken, in respect of this question, between the case where it is provided in the charter that transfers shall be made only on the books of the corporation, and the case where such a provision is found only in the by-laws of the corporation. The charter, being a public law, of which all persons are bound to take notice,

[1] *Ante*, § 2353; *post*, § 2587.

[2] Shenandoah Valley R. Co. *v.* Griffith, 76 Va. 913.

[3] Young *v.* South Tredegar Iron Co., 85 Tenn. 189; *s. c.* 4 Am. St. Rep. 752.

[4] Kyle *v.* Montgomery, 73 Ga. 337.

if the provision is there found, a transfer not made on the books of the corporation will not be good. It has been so held, against an *attaching creditor* of the vendor, although notice of the transfer may have been communicated *to the corporation* before the levying of the attachment.[1] But it was decided in the same State that an assignment of shares by deed, accompanied by a delivery of the certificates to the purchaser, was valid against attaching creditors, although the by-laws of the corporation required that all transfers should be made in the treasurer's books. The court proceeded upon the view that the by-laws were merely an arrangement of the corporation for their own convenience for the purpose of regulating the payment of dividends, etc., and did not affect strangers to the corporation.[2]

§ **2416. Notice to Corporation Immaterial.** — Notice to the corporation of such unrecorded transfer is obviously immaterial where this rule prevails,[3] except where the corporation is itself the creditor of the transferor; since the attaching creditor would not be affected by such notice. It was so held even where the transferee wrote to the corporation requesting that the shares be transferred to him on its books, and the corporation made a minute of the transfer on the certificate stub in the book of the corporation, for the reason that it had no transfer book,— a case which seems to carry the principle very far.[4] But if the corporation is the creditor, and has notice, actual or constructive, the rule is different; and it has been held that constructive notice may come to the corporation through its president where he sells the shares and afterwards ceases to act as president, and the shares are attached by the company as his property before the transfer has been made on the corporate books.[5]

§ **2417. How in Respect of Shares of National Banks.** — It has been held with respect of shares of national banks that an

[1] Fisher *v.* Essex Bank, 5 Gray (Mass.), 373, 379; *Ante*, § 1032.

[2] Sargent *v.* Essex Marine Ry. Co., 9 Pick. (Mass.) 202.

[3] Fisher *v.* Essex Bank, 5 Gray (Mass.), 373.

[4] Newell *v.* Williston, 138 Mass. 240. The case was decided under an express statutory provision that shares should be transferable only *on delivery of the certificate.*

[5] Scripture *v.* Francestown Soapstone Co., 50 N. H. 571.

unrecorded transfer for value and in good faith prevails over a *subsequent attachment* by a creditor of the assignor.[1]

§ 2418. Reasonable Time Allowed for Transfer on the Books. — There is a theory in the law of chattel mortgages which allows such a mortgagee a reasonable time for placing the mortgage on record before his rights can be intercepted by an attaching creditor of the mortgagor. In one case an analogous holding is found in respect of transfers of corporate shares; resulting in the conclusion that, where the transfer was made at a distance from the office, and the old certificates surrendered and new ones given by a transfer agent appointed for that purpose and residing in a neighboring State, proof that the proper evidence of such transfer was sent by the earliest mail communication to the keeper of the stock record, to be entered, although not received until an attachment had intervened, will be sufficient explanation of the want of delivery, and such transfer will be good against the creditor.[2] But where the pledge was made in Boston on the 8th day of July, by a delivery over of the certificates, and nothing more was done until the third day of the following August, and then the old certificates were surrendered to the transfer agent there, and new ones received from him, and notice given by the first mail to the office at Manchester in New Hampshire, — it was held, as against an attachment made between the obtaining the new certificates, and the notice to the office, that the possession was not seasonably taken and that the transfer, therefore, was not valid.[3]

§ 2419. Assignment after a Levy by one Creditor and before a Levy by Another. — Where certain shares of railroad stock, which the owner had agreed to sell and transfer, had been attached, and the secretary of the company refused, on the application of the vendor, to allow a transfer on the books of the company of the stock so attached, and the vendor, thereupon, in good faith, made a written assignment of the stock by a separate instrument, and lodged it with the secretary, it was held that the title of the vendee was good against

[1] Continental Nat. Bank *v.* Eliot Nat. Bank, 7 Fed. Rep. 369; *s. c.* 37 Am. Rep. 353, note; Compare Scott *v.* Pequonnock Bank, 15 Fed. Rep. 494.

[2] Pinkerton *v.* Manchester &c. R. Co., 42 N. H. 424.

[3] *Ibid.*

later attachments of the stock by the creditors of the vendor. The court reasoned that the ground upon which stock sold, but not legally transferred, is open to attachment by creditors of the vendor, is the same upon which personal chattels sold, but retained in the possession of the vendor, are liable to attachment as the property of the latter; and the same circumstances that would excuse the failure to take possession in the one case, will excuse the failure to perfect the transfer in the other.[1]

§ 2420. Levying Execution after Transfer on the Books. — It is scarcely necessary to say that, after a valid transfer has been made on the books of the corporation, a creditor acquires no rights by virtue of the levy of his execution; and, as hereafter seen, whether he thereby acquires an *equitable title* which enables him to maintain a bill to set aside the transfer, depends on theories of law which differ in different States.[2] In Missouri, one who levies upon and sells bank stock under an execution against a former owner, in ignorance of the fact that such former owner has transferred the stock on the books of the bank, obtains no title by his purchase at the execution sale, and cannot be held as a stockholder by a creditor of the bank. Nor does it matter that he demanded, after his purchase, that the stock be transferred to him upon the bank books and brought suit against the bank on its refusal, he having dismissed his suit on learning the facts and repudiated a transfer to himself on learning of it.[3]

§ 2421. Statutes making Transfers Void as against Bona Fide Creditors or Subsequent Purchasers without Notice. — A statute of Alabama provides that the shares of stock of any person in an incorporated company are personal property, and transferable on the company's books as such company may prescribe, and may be levied on by attachment and execution, and sold as goods and chattels.[4] Another section provides that "when, by the charter, articles of association, or by-laws and regulations of an incorporated company, the transfer of the stock is required to be made upon the book or books of such company, no such transfer of stock shall be valid as

[1] Colt *v.* Ives, 31 Conn. 25; *s. c.* 81 Am. Dec. 161.

[2] *Post*, § 2772.

[3] Simmons *v.* Hill, 96 Mo. 679; *s. c.* 2 L. R. A. 476; 10 S. W. Rep. 61; 5 Rail. & Corp. L. J. 160.

[4] Code Ala. 1876, § 2041.

against *bona fide creditors* or subsequent purchasers, without notice, except from the time that such transfer shall have been registered, or made, upon the book or books of such company."[1] Another section provides that persons holding stock not so transferred must have the transfer made on the books of the company, or, upon failing to do so within fifteen days, the transfer shall be void as to *bona fide* creditors, or subsequent purchasers without notice.[2] The uniform interpretation of the words "*bona fide creditors*" in this, as in similar statutes, is to mean judgment creditors having a lien.[3] "When the sale is made under execution, the lien of which has attached before notice, actual or constructive, the purchaser, although having notice at the time of the purchase, will acquire a good title. In such case, the creditors' execution lien comes to the aid of the purchaser's title and perfects it. This is the only mode by which the *bona fide* creditor without notice can realize the benefit of the lien the statute gives him.[4] It is also held that an attaching creditor who perfects his lien by the recovery of a judgment is a *bona fide* creditor from the inception of his lien, and that where the purchaser of stock fails to have it transferred on the company's books within fifteen days, the stock becomes liable to attachment at the suit of any creditor of the person in whose name the stock stood on the books.[5] A statute of Rhode Island enacts: "The delivery of a certificate of stock of a corporation, transferable only on the books of the corporation on surrender of the certificate, to a *bona fide* purchaser or pledgee for value, together with a written transfer of the same, or a written power of attorney to sell, assign, and transfer the same, signed by the owner of the certificate, shall be a sufficient delivery to transfer the title against all parties."[6]

[1] *Ibid.*, § 2048.

[2] *Ibid.*, § 2044.

[3] Jones *v.* Latham, 70 Ala. 164; *s. c.* 9 Am. Corp. Cas. 16; Berney National Bank *v.* Pinckard, 87 Ala. 577; 6 *s. c.* South. Rep. 364. As to this general principle of interpretation in respect of statutes of this kind, see Daniel *v.* Sorrells, 9 Ala. 436; De Vendell *v.* Hamilton, 27 Ala. 156; Preston *v.* McMillan, 58 Ala. 84.

[4] Jones *v.* Latham, 70 Ala. 164; *s. c.* 9 Am. Corp. Cas. 16; opinion by Stone, C. J.

[5] Berney National Bank *v.* Pinckard, *supra.*

[6] R. I. Act March 22, 1888; Acts 1888, c. 690, p. 202.

Article VII. Compelling Transfers in Equity.

§ **2425. Equity Will Compel Transfers.**— Equity will, under proper circumstances, compel a corporation to transfer on its books shares of stock to the owner of the equitable title and to issue to him certificates for the same.[1] Speaking with reference to this subject, it has been said: "The jurisdiction which courts of equity exercise over individuals extends equally to acts done or omitted to be done by private or municipal corporations; and the power to compel a transfer of specific property is a salutary one, and should be exercised where such relief alone will work a complete and ample remedy."[2] A complaint which alleges that the plaintiff is the owner of certain shares of stock in the defendant corporation, and that the corporation has recog-

[1] Iron R. Co. *v.* Fink, 41 Oh. St. 321; *s. c.* 52 Am. Rep. 84; Cushman *v.* Thayer Man. Co., 76 N. Y. 365; *s. c.* 32 Am. Rep. 315; Middlebrook *v.* Merchants' Bank, 41 Barb. (N. Y.) 481; *s. c.* 18 Abb. Pr. 109; 27 How. Pr. (N. Y.) 474; *s. c.* affirmed 3 Abb. App. Dec. 295; Mechanics' Bank *v.* Seton, 1 Pet. (U. S.) 299; Hill *v.* Rockingham Bank, 44 N. H. 567; Tanner *v.* Gregory, 71 Wis. 490. Compare Dousman *v.* Wisconsin &c. Co. 40 Wis. 418.

[2] Cushman *v.* Thayer Man. Co., *supra.* Compare Pollock *v.* National Bank, 7 N. Y. 274; Purchase *v.* New York Exchange Bank, 3 Rob. (N. Y.) 164; White *v.* Schuyler, 1 Abb. Pr. (N. Y.) 300; Buckmaster *v.* Consumers' Ice Co., 5 Daly (N. Y.) 313; Seymour *v.* Delancey, 6 Johns. Ch. (N. Y.) 222; *s. c.* 3 Cow. (N. Y.) 445; 15 Am. Dec. 270.

nized him as such but refuses to deliver to him the certificates therefor, states an equitable cause of action.[1]

§ **2426. Illustration.**— Where the officers of a corporation, formed by the consolidation of two other companies, into whose hands a large amount of stock of the new company had come for distribution to the stockholders of the old companies pursuant to the terms of the consolidation agreement, withheld a portion of it and were thereby put in a position, through the control so acquired, seriously to prejudice the interests of those who were justly entitled to the transfer, and so acted as to make their purpose to accomplish that prejudice apparent, it was held that the meetings they could control would be stayed by injunction until the transfers could be compelled.[2]

§ **2427. Equity Will Decree Transfers and Payment of Dividends.**— In an action against a corporation to compel it to transfer the plaintiff's shares to him on its books, the plaintiff may have a decree for the transfer and also for the payment of the dividends which have accrued on the shares, with interest.[3]

§ **2428. Will Compel Transfer to an Assignee in Bankruptcy.** — When a stockholder is adjudicated bankrupt, his title to the shares passes by the assignment to the assignee; and where the bankrupt had fled from the jurisdiction, taking with him his certificate of the shares, his assignee, having tendered a sufficient bond of indemnity, was held to be entitled to maintain a bill against the company, to have the stock transferred to his name on the books of the corporation.[4]

§ **2429. Where a Second Certificate has been Wrongly Issued in Lieu of One Reported Lost.** — By the terms of a stock certificate, it was transferable upon the books of the corporation only upon its production. B., the owner of such a certificate, transferred it to A. No transfer was made on the books. After B.'s death, his administrator represented that the certificate was lost, and the corporation thereupon issued a new

[1] Tanner *v.* Gregory, 71 Wis. 490.

[2] Archer *v.* American Water Works, 50 N. J. Eq. 33; *s. c.* 24 Atl. Rep. 508.

[3] Chew. *v.* Bank of Baltimore, 14 Md. 299. Compare Brisbane *v.* Lackawanna &c. R. Co., 94 N. Y. 204; Telegraph Co. *v.* Davenport, 97 U. S. 369.

[4] Wilson *v.* Atlantic &c. R. Co., 2 Fed. Rep. 459.

one to him, and made a transfer on his books, and paid to him dividends. It was held that, notwithstanding this, A. could compel the issue of a certificate to himself.[1] The second certificate was void. The corporation issued it at its peril and could not set up its own mistake as a defense to the right of A. to the relief which he sought.

§ 2430. Illustrations: Other Cases where Transfer on Corporate Books was Compelled in Equity. — A. transferred as a gift to his wife certain shares of stock in a corporation, by an assignment on the back of the certificate, which assignment was witnessed by B., who was an officer of the corporation, and was accompanied by a power of attorney authorizing the wife to act for the assignor. Subsequently A. assigned the same stock to B. for a trifling consideration, without delivering the certificate to B., and B., with the knowledge of the claim of A.'s wife, transferred the stock to himself on the books of the company. The stock was not transferable except on surrender of the certificate. The wife of A., procuring the certificate and power of attorney, demanded from the corporation a transfer of the shares to herself, which was refused. She thereupon brought an action in the nature of a bill in equity to compel the transfer; and it was held that she was entitled to such relief and was not restricted to an action for damages.[2] Where one whose stock in a corporation had been sold under a judgment, collusively obtained by procurement of its officers, against the person from whom he purchased it, the court held that, although the stock was not registered in his name, he could maintain an action against the corporation and its officers, who had wasted and appropriated its assets, to have his rights as a stockholder established, the certificates issued in place of those held and owned by him cancelled, and for an accounting.[3] Shares in the stock of a gaslight company domiciled in South Carolina were *sequestered under an act of the Confederate government* and sold, during the late civil war. In lieu of the original certificates, other share certificates of corresponding amounts were delivered to the purchaser. After

[1] Brisbane *v.* Delaware &c. R. Co., 94 N. Y. 204; affg. *s. c.* 25 Hun (N. Y.), 438.

[2] Cushman *v.* Thayer Man. Co., 76 N. Y. 365; *s. c.* 32 Am. Rep. 315. For a case where certain allegations about the inconvenience to the company, its stockholders and citizens of New York, of allowing a California receiver to interfere, were stricken out on motion,—see Weller *v.* Pace Tobacco Co., 42 Hun (N. Y.), 659, mem; *s. c.* 4 N. Y. St. Rep. 652.

[3] Sims *v.* Bonner (N. Y. Super. Ct.), 42 N. Y. St. Rep. 14; *s. c.* 16 N. Y. Supp. 801.

the close of the war, although the company admitted the sales to have been void and recognized the rights of the original stockholder, yet it neglected to take any step to have the certificate issued under the sale for sequestration declared void, or to have it delivered up and cancelled. It was held, by Mr. Chief Justice Chase at circuit, that any stockholder whose stock had thus been sold had a remedy in equity to have the spurious certificate delivered up and cancelled as a cloud upon his title.[1] Where a non-resident fraudulently procured certificates of stock by representing himself as owner of shares belonging to a member of a corporation which had voted to sell its stock for that of a new corporation, to be held in escrow by the trust company which issued the certificate, he was ordered to surrender the certificates to the trust company; and the latter was ordered, upon their surrender, to deliver up to the real owner the stock represented by such certificates.[2]

§ 2431. Not Compelled in the Face of Superior Opposing Equities. — A proceeding to compel the specific performance of a contract being a remedy purely equitable, the right to relief does not rest on merely technical grounds, but the jurisdiction appeals to the conscientious discretion of the chancellor. Such a decree will not be made in the face of superior opposing equities. It was refused to a person who had acquired possession of certain stock certificates, as the agent and instrument of a trust company, to enable it to commit a fraud on the rights of a stockholder.[3] It was denied under the following circumstances: A. B., having sufficient funds in bank, paid by his check for certain shares of stock in a corporation, which were transferred on the books thereof to his credit, but no certificate was issued. The bank being notified of an adverse claim to his deposit, growing out of previous and independent frauds which he had committed, refused to pay the check, and he became bankrupt. It was held that the *seller* of the shares could not maintain a bill in equity against A. B. and the corporation to compel a conveyance thereof. The previous frauds did not taint this transaction. Consequently the stock belonged in equity, to the assignees of A. B., to be distributed among his creditors with his other property.[4]

[1] Perdicaris *v.* Charleston Gas Light Co., Chase Dec. (U. S.) 435.

[2] Bean *v.* American Loan &c. Co., 122 N. Y. 622; *s. c.* 34 N. Y. St. Rep. 620; 26 N. E. Rep. 11.

[3] Gould *v.* Head, 41 Fed. Rep. 240.

[4] Comins *v.* Coe, 117 Mass. 45.

§ **2432. Not Compelled where there has been Laches.** — So, on a familiar doctrine, equities may arise in favor of third persons which will operate to cut off the right to this remedy, in case of unreasonable *delay* in asserting it. Thus, it has been held that a purchaser of stock in a corporation, sold under an execution, is bound to have it transferred to himself within a reasonable time; and that if he neglects to do so within several years while the affairs of the corporation, to his knowledge, are undergoing such changes as would make its interest and the rights of new stockholders incompatible with the enforcement of his claim, he will not be entitled to the aid of equity in such enforcement.[1] So, seven years delay in bringing suit for specific performance of an agreement to issue corporate stock to an employé, was held, in the absence of explanation, in a suit brought after he left the company's employment, to be inexcusable laches.[2] The same principle has been applied where the suit is against an individual. Thus, where plaintiff bought shares of a firm, which at the time had a large number of shares standing to its credit on the books of the company, but delayed for some months to present his power of attorney and have the shares transferred to his name, and in the meanwhile the firm sold all its shares to other persons, who obtained certificates from the corporation, the court held that the plaintiff was not entitled, in equity, as against a partner who had no knowledge of the transactions, to a decree for the delivery to him of a certificate of the shares of stock, which had risen in value; that he was only entitled to a decree for the money which he had paid, with interest.[3]

§ **2433. Conclusiveness of Transfer under a Decree.**— How far a transfer under a decree will conclude the rights of a subsequent innocent purchaser where the certificate is not surrendered, is a more difficult question. On principle it will not conclude him at all. As to him the proceeding which resulted in the decree is *res inter alios acta*, and it has been well held that he is not

[1] Newberry *v.* Detroit &c. Co., 17 Mich. 141.

[2] York *v.* Passaic Rolling Mill Co., 30 Fed. Rep. 471.

[3] Wonson *v.* Fenno, 129 Mass. 405.

affected by the doctrine of *lis pendens*.[1] Nevertheless, it has been held that the stock of a corporation in Massachusetts, is so within the power of its courts, having all proper parties before them, that their decree will operate upon the title of the stock, and may transfer it to a third person, notwithstanding the certificate therefor is outstanding. The court further took the view that in such a case, after all means have been exhausted, through regular judicial proceedings, the corporation is not bound to recognize the title of one who, years afterwards, produces the certificate, with the signature of the former owner to a blank assignment, and proves that, since such judicial proceedings, he has advanced money on the faith of the certificate.[2]

§ 2434. Transfer of Ultra Vires Stock not Compelled.— So, a corporation cannot be compelled to make transfer, upon its books, of stock which has been issued in violation of the charter, even though all the stockholders may have consented to the issue.[3]

§ 2435. Contract to Sell not Specifically Performed. — A contract for the sale of stock will not, in general, be specifically enforced in equity. But the denial of relief in equity proceeds upon the ground that the party claiming relief may have adequate compensation in an action at law for damages, and it seems that the rule itself is limited to cases where such compensation may be had.[4]

§ 2436. Equity will not Execute Gift by Compelling Transfer by Corporation.—A *gift* of corporate stock which has not been effectuated by a transfer on the corporate books has been held to stand on the same footing as the gift of a chattel which has not been effectuated by delivery. The title to a chattel by

[1] Holbrook *v.* New Jersey Zinc Co., 57 N. Y. 616; Leitch *v.* Wells, 48 N. Y. 586. See also Dovey's Appeal, 97 Pa. St. 153; *Post*, § 2604.

[2] Sprague *v.* Cocheco Manuf. Co., 10 Blatchf. (U. S.) 173.

[3] People *v.* Sterling Manuf. Co., 82 Ill. 457.

[4] Phillips *v.* Berger, 2 Barb. (N. Y.) 608; Story Eq. Jur., §§ 717, 718; Miller, J., in Cushman *v.* Thayer Man. Co., 76 N. Y. 365; *s. c.* 32 Am. Rep. 315; Compare Cowles *v.* Whitman, 10 Conn. 121; *s. c.* 25 Am. Dec. 60.

gift, it is well known, does not pass until delivery.[1] The mere promise to give is *nudum pactum* and is not enforceable. If, therefore, one who has promised to give dies before he has executed the promise by delivering the thing which he promised to give, the title will pass to his personal representative, and the latter cannot be compelled to execute the promise to give.[2] On like grounds, it is held that where the constating instrument provides that shares of the corporate stock shall be transferred only on the books of the corporation, if a shareholder promises even in writing — as by an instrument in the form of an assignment — to give his shares to another, the gift is not enforceable after his death, by a proceeding in equity against the corporation, any more than it could be enforced against him in his life-time;[3] though it would be otherwise if such an inchoate transfer were made for *value*, or if the certificate were delivered to the donee.[4]

§ 2437. **Demand is not Ordinarily Necessary** to a right of action; though there are circumstances where no wrong is done to the defendant until he has demanded of the plaintiff the thing sued for and his demand has been refused. Thus, if A. lets his horse to B. for an indefinite length of time, and then brings an action of trover in respect of it, without first making a demand for its return, and before B. has done any act which amounts in law to a conversion, A. cannot on sound principles recover, because, at the commencement of the action no legal wrong had been done him by B. So, if A., having a deposit in bank, sues the bank for it, without first demanding its payment by presenting his check in the usual way, he ought not, on general grounds, to be allowed to recover, for the same reason. In these cases, as in most others, the action succeeds or fails according to the state of facts existing at the time when it was commenced. But the plea of a want of demand is often a

[1] Robinson *v.* Ring, 72 Me. 140; *s. c.* 39 Am. Rep. 308. See note, 39 Am. Rep. 310.

[2] Conser *v.* Snowden, 54 Md. 175; *s. c.* 39 Am. Rep. 368; Wilcox *v.* Matteson, 53 Wis. 23; *s. c.* 40 Am. Rep. 754.

[3] Baltimore Retort &c. Co. *v.* Mali, 65 Md. 93; *s. c.* 57 Am. Rep. 304; Pennington *v.* Gittings, 2 Gill & J. (Md.) 208. But see Stone *v.* Hackett, 12 Gray (Mass), 227; Cushman *v.* Thayer Man. Co., 76 N. Y. 365; *s. c.* 32 Am. Rep. 315.

[4] *Ante*, § 2390.

mere dilatory plea; and in some of the States the legislatures, to get rid of this plea, have enacted statutes abolishing the necessity of a demand in any action brought for money or property.[1] It is obvious, with reference to the question we are considering, that the circumstances might often be such that it would be inequitable to put the corporation to the expense of defending an action for the specific performance before demand and refusal have been made; for why should the corporation be sued for not doing what it has not been asked to do? But where one who had purchased certain shares at a sheriff's sale on execution, the corporation having under its charter a pre-emption right in respect of its stock or an option of purchasing it in preference to any one else, filed a bill in equity against the corporation to compel a transfer of the purchased stock without first *demanding* such transfer, — this was held no reason for dismissing the bill.[2]

§ 2438. **An Illustration of this Principle.** — M. owned two shares of stock in a supply ditch company, each of which entitled him to take ten inches of water, upon applying for water before May 20, and paying one dollar per inch or securing the company for all the water he might use. These shares he pledged to P. before receiving his certificate, but the company had notice of and recognized P.'s rights. Thereafter M. absolutely assigned the shares to E. Subsequently the company issued to P. certificates for the shares pledged to him, and a judgment having been recovered against him, they were sold by the sheriff under an execution and purchased by B., who filed the certificate of sale with the company. On May 19, E. applied to the company for twenty inches of water and tendered the $20, without informing it of his claim to the shares under the assignment by M., and his demand and tender were refused. About June 1, E. produced to the company an order from M. directing it to transfer to E. the two shares, and about the same time P. in writing directed the company to release to E. all his interest in the stock. Upon presentation of these orders to the company, E. demanded the transfer of the stock to him, but made no demand for water, nor did he tender payment or security for the twenty inches of additional water demanded on May 19; nor did he offer to surrender the certificates of stock, which were then in possession of P.

[1] R. S. Mo. 1889, § 2948; *Id.* 1879, § 1018. See Nanson *v.* Jacob, 93 Mo. 331; White Sewing Machine Co. *v.* Betting, 46 Mo. App. 417.

[2] Barrows *v.* National Rubber Co., 12 R. I. 173.

The company refused to make the transfer, whereupon E. took forcible possession of twenty inches of water. The court held, in an action brought by the company for the trespass, that as E., on June 1, when the demand was made for the transfer, did not produce the certificates or give any excuse for the failure to do so, nor demand the water or tender payment therefor, E. had no right to take the water.[1]

§ **2439. Ratification of the Unauthorized Act of the Corporation.** — The act of a corporation in transferring shares of stock without the authority of the owner, is not ratified by the fact that the latter told another agent than the one on whose application the transfer was made, that he would not hold him responsible for delivering the certificates to the agent who applied for the transfer.[2]

§ **2440. Parties to Such Actions.** — It has been held that the corporation is not a necessary party to an *action against its officers* to compel them to transfer stock;[3] but this is doubtful. In an action against a corporation to compel it to transfer to the plaintiff certain shares of its stock, which the plaintiff has acquired by purchase under a *mortgage foreclosure* sale, the *prior owner* is not a necessary party defendant.[4] A similar ruling was made by the Supreme Court of the United States in an early case, where the prior owner, having sold the stock, was ready and entirely willing to make the transfer.[5]

§ **2441. No Jury.** — Such an action is purely one of equitable cognizance, and the defendant cannot demand a trial by jury.[6] But, of course, the chancellor may, as in other cases, take the verdict of a jury on any issue of fact, but without being bound by it.

[1] Supply Ditch Co. *v.* Elliot, 10 Col. 327; *s. c.* 3 Am. St. Rep. 586; 15 Pac. Rep. 691.

[2] Quay *v.* Presidio &c. R. Co., 82 Cal. 1; *s. c.* 22 Pac. 925.

[3] Gould *v.* Head (Col.), 41 Fed. Rep. 240. Compare Sayward *v.* Houghton, 82 Cal. 628; *s. c.* 23 Pac. Rep. 120. When shareholder entitled to change of venue to his own county. *Ibid.*

[4] Tregear *v.* Etiwanda Water Co. 76 Cal. 537; *s. c.* 9 Am. St. Rep. 245.

[5] Mechanics Bank *v.* Seton, 1 Pet. (U. S.) 299.

[6] Cushman *v.* Thayer Manuf. Co., 7 Daly (N. Y.), 330.

ARTICLE VIII. MANDAMUS TO COMPEL TRANSFERS.

SECTION 2445. Whether mandamus will lie to compel transfers.

§ 2445. Whether Mandamus will Lie to Compel Transfers. — One who is entitled to have shares which he has purchased transferred to him on the books of the corporation can not, at common law, have a mandamus to compel the transfer, for the reason that he has a right of action against the company for *damages for the conversion* of his stock in case a transfer is refused.[1] Exceptions to this rule have been allowed in the case of *railroad*[2] and *turnpike* companies,[3] on the ground that such corporations are created for the performance of *public duties.* But this reason is destitute of force; since, in respect of the rights of their members, these corporations are not public, but private.[4] It has been held that mandamus will lie, where the shares have been sold at a judicial sale, to compel the presi-

[1] Kimball *v.* Union Water Co., 44 Cal. 173; *s. c.* 13 Am. Rep. 157; Tobey *v.* Hakes, 54 Conn. 274; *s. c.* 1 Am. St. Rep. 114; Shipley *v.* Mechanics Bank, 10 Johns. (N. Y.) 484; Kortright *v.* Buffalo Com. Bank, 20 Wend. (N. Y.) 91; *s. c.* in error, 22 Wend. 348; 34 Am. Dec. 317; Ex parte Firemens Ins. Co., 6 Hill (N. Y.), 243; Rex *v.* Bank of England, 2 Doug. (Eng.) 546; Wilkinson *v.* Providence Bank, 3 R. I. 22; American Asylum &c. *v.* Phœnix Bank, 4 Conn. 172; *s. c.* 10 Am. Dec. 112; State *v.* Rombauer, 46 Mo. 155; State *v.* Peoples &c. Asso., 43 N. J. L. 389; Baker *v.* Marshall, 15 Minn. 177; State *v.* Timken, 48 N. J. L. 87; Rex *v.* London Assurance Co., 1 Dow. & Ryl. 510; *s. c.* 5 Barn. and Ald. 899; Stackpole *v.* Seymour, 127 Mass. 104; State *v.* Guerrero, 12 Nev. 105; Durham *v.* Monumental &c. Co., 9 Or. 41. In several cases mandamus has been denied on the merits, on the ground that the right to relief was not clear. People *v.* Vein Coal Co., 10 How. Pr. (N. Y.) 186; State *v.* Warren &c. Co., 32 N. J. L. 439; Townes *v.* Nichols, 73 Me. 515; Reg. *v.* Liverpool &c. R. Co., 21 L. J. (Q. B.) 284; *s. c.* 16 Jur. 949; Law Guarantee &c., Soc. *v.* Bank of England, 24 Q. B Div. 406; *s. c.* 8 Rail. and Corp. L. J. 47.

[2] State *v.* McIver, 2 South Car. 25; People *v.* Crockett, 9 Cal. 112 (no reason given except a discussion of the merits; overruled by Kimball *v.* Union Water Co., 44 Cal. 173; *s. c.* 13 Am. Rep. 157). Compare Reg. *v.* Shropshire Union Railways, L. R. 8 Q. B. 420 (submitted on a case stated, no question made as to form of remedy, but judgment awarding mandamus reversed in House of Lords. L. R. 7 H. L. 496).

[3] Green Mount &c. Turnp. Co. *v.* Bulla, 45 Ind. 1.

[4] See Stackpole *v.* Seymour, 127 Mass. 104, where such a mandamus was denied in case of a railroad company, — the Court, through Gray, C. J., saying "no public interest or corporate right is in question."

dent of the corporation to transfer them to the purchaser on the books of the company, on the ground that he has become the officer of the court *pro hac vice*.[1] But the same court holds that, with this exception, mandamus will not lie to compel such a transfer.[2] Sometimes the rule which refuses relief by mandamus is admitted, but with the qualification that the remedy may exist where there is a breach of duty in respect of incidental rights, such as the right to vote and be voted for, to draw dividends, etc.[3] It has been held that the fact that the business of the corporation is very profitable, that its shares of stock have no known market value, or are greatly enhanced by the good-will of a growing business, will not vary the rule, where the actual value is ascertainable in an action to recover damages.[4] It may be observed that the remedy by an action for the conversion is, in many cases, clearly inadequate, and the rule of these cases is hence unsound on principle. A large shareholder in a corporation may, by the purchase of a few additional shares, acquire a controlling vote therein. This vote may be to him of many times more value than the value of the shares which, if properly transferred to him, would enable him to exercise it. But the officers of the corporation may remain in power and in possession of its assets, repudiate his rights, and tortiously perpetuate their official existence, and his only *legal* remedy for this great wrong is to have the assets of the corporation mulcted, and other innocent shareholders perhaps damaged, to the extent of the market value of his shares thus converted. These considerations have given rise to the remedy in equity by a bill in the nature of a bill for specific performance considered in the previous article.[5]

[1] Bailey *v.* Strohecker, 38 Ga. 259; *s. c.* 95 Am. Dec. 388.

[2] Bank *v.* Harrison, 66 Ga. 696.

[3] Freon *v.* Carriage Co., 42 Oh. St. 30, 39; *s. c.* 51 Am. Rep. 794. Compare Memphis Appeal Co. *v.* Pike, 9 Heisk. (Tenn.) 698.

[4] Freon *v.* Carriage Co., 42 Oh. St. 30, 39; *s. c.* 51 Am. Rep. 794.

[5] Cushman *v.* Thayer Man. Co., 76 N. Y. 365; *s. c.* 32 Am. Rep. 315.

Article IX. Action at Law for Refusal to Register.

§ 2447. Refusal to Register a Valid Transfer is a Conversion. — Where a transfer of shares has been made in accordance with the charter and by-laws of the corporation, if the officers of the corporation refuse, on the application of the transferee, to enter his name as a holder of the shares upon the corporate books, this is deemed a conversion of his shares by the corporation, and his remedy is an action at law against the corporation as for a conversion.[1] It was so held, too, of a refusal to issue a certificate to the *assignee* of one who had subscribed to

[1] Sargent *v.* Franklin Ins. Co., 8 Pick. (Mass.) 90; *s. c.* 19 Am. Dec. 306; Mechanics Bank *v.* New York &c. R. Co., 13 N. Y. 599, 624; New York &c. R. Co. *v.* Schuyler, 34 *Id.* 30, 80; Kortright *v.* Buffalo Commercial Bank, 20 Wend. (N. Y.) 91; St. Louis Perpetual Ins. Co. *v.* Goodfellow, 9 Mo. 150; Kahn *v.* Bank of St. Joseph, 70 Mo. 262.

the capital of a company and was entitled to the rights of a stockholder, but to whom no certificate had ever been issued.[1]

§ 2448. So also, a Wrongful Transfer to One Without Right. — So, when a company, having notice of the adverse claim of plaintiff to the stock, which is in litigation, nevertheless ignores it and transfers the shares on its books to the indorsee of the certificate, it does so at its peril, and can not avoid liability to the plaintiff simply on the ground that no preliminary injunction restraining its action has been obtained.[2] But where the company acts without *notice* of such adverse claim, it cannot be held *to such* a liability. Thus, a corporation, which in good faith accepts the surrender of old stock certificates from one holding a power of attorney authorizing him to transfer them, and issues new certificates to the purchasers, is not liable for the stock to the owners although such attorney surreptitiously obtained possession of the stock, and converted the proceeds to his own use.[3]

§ 2449. No Direct Remedy Against the Officers. — It seems that he has no direct remedy against the directors or other officers of the corporation. He is not in privity with them. It is not regarded as a case of *misfeasance*, in which a stranger would have an action directly against the person doing him an injury, although such person may have claimed to act as the agent or servant of another; but it is rather a case of *non-feasance*, in which the duty claimed flows from the corporation to the transferee of the shares, and not from its officers or agents; the latter being responsible only to the corporation itself.

§ 2450. Doctrine that Trover Lies for the Conversion of Shares. — It has been well said that stock in a corporation is a collection of rights against a corporation.[4] Many courts hold that shares, considered as ideal property, and distinguished from

[1] Rio Grande Cattle Co. *v.* Burns, 82 Tex. 50; *s. c.* 17 S. W. Rep. 1043. Compare Baltimore City Pass. R. Co. *v.* Sewell, 35 Md. 238; *s. c.* 6 Am. Rep. 402.

[2] Hawes *v.* Gas Consumers Ben. Co., 9 N. Y. Supp. 490.

[3] Coats *v.* Louisville & N. R. Co. 92 Ky. 263; *s. c.* 17 S. W. Rep. 564.

[4] Lowell Transfer of Stock, § 11.

the certificate, which, as already seen,[1] is the mere evidence or muniment of title, may be the subject of a conversion in such a sense as to support an action of trover at common law.[2] This right of action arises against an individual who, by a wrongful use of a share certificate, bearing an executed assignment and transfer power, procures the title to the shares to be vested in a person not entitled thereto,[3] and against the corporation itself when it totally denies the plaintiff's rights as a shareholder therein and repudiates its obligations to him as such.[4] For instance, it has been held that the action lies where the company has practically deprived the plaintiff of his stock by bidding it in at a pretended sale under its by-laws, although such sale is in fact illegal and void, as not having been conducted in compliance with the by-laws purporting to authorize it.[5]

§ 2451. View that there is no Sensible Distinction between a Conversion of the Certificate and a Conversion of the Shares. — The courts which so hold are unable to perceive any valid reason why trover should lie for the certificate, which is merely the paper evidence of the title of the shareholder to the shares, and yet should not lie for the shares themselves. Nor are they able to perceive any sensible distinction between an action for a certificate of stock which is unlawfully retained when demanded, for which it has always been held trover will lie, and an action for the shares represented by the certificate and without which the paper itself has no intrinsic value.[6] Thus, the Supreme Court of Connecticut say:

[1] *Ante*, §§ 1962, 2349 2 *et seq.*

[2] Ayres *v.* French, 41 Conn. 142; Boylan *v.* Huguet, 8 Nev. 345, 352; Payne *v.* Elliott, 54 Cal. 339; *s. c.* 35 Am. Rep. 80; Anderson *v.* Nicholas, 28 N. Y. 600; Maryland Fire Ins. Co. *v.* Dalrymple, 25 Md. 242; *s. c.* 89 Am. Dec. 779; Jarvis *v.* Rogers, 15 Mass. 389; Kuhn *v.* McAllister, 1 Utah T. 273; *s. c.* affi'd 96 U. S. 87; Bond *v.* Mt. Hope Iron Co., 99 Mass. 505; *s. c.* 97 Am. Dec. 49; Freeman *v.* Harwood, 49 Me. 195; Connor *v.* Hillier, 11 Rich. L. (S. C.) 193, 195. Doctrine recognized in Daggett *v.* Davis, 53 Mich. 35; *s. c.* 51 Am. Rep. 91.

[3] McAllister *v* Kuhn, 96 U. S. 87; Baker *v.* Wasson, 53 Tex. 150.

[4] Bond *v.* Mt. Hope Iron Co., 99 Mass. 505; *s. c.* 97 Am. Dec. 49. That trover lies by the owner of stock who has pledged it as collateral for a *usurious loan*, see Cousland *v.* Davis, 4 Bosw. (N. Y.) 619.

[5] Allen *v.* American Building &c. Asso., 49 Minn. 544; *s. c.* 52 N. W. Rep. 144; 32 Am. St. Rep. 574.

[6] See *post*, § 2642, *et seq.*

"If a certificate of stock is unlawfully retained when demanded, what is presumed to have been converted? The certificate has no intrinsic value disconnected from the stock it represents. No one would say that the paper alone had been converted — that the conversion of the paper constitutes the entire wrong. The real act done in such cases is precisely the same as that done here — no more, no less; and to say that trover will lie in one case and not in the other, is to make a distinction where in reality there is no difference. * * * The stock in both cases was converted; and we think that in these days, when the tendency of courts is to do away with technicalities not based upon reason, a technical distinction of this character should no longer be sustained."[1] So, in Michigan, the doctrine has been broadly laid down upon consideration, that trover lies for shares of corporate stock, and not merely for the certificate. In the opinion of the court, so holding, Cooley, C. J., says: "We see no reason why, if the shares are converted by means of the wrongful use of the certificate, the owner in suing may not count upon the conversion of either. The shares are the property converted, but the certificate itself is also property, standing as it does as the representative of the shares; and as its conversion may take the shares from the owner, it seems to be as proper to count upon its conversion as upon the conversion of money or any chattel."[2]

§ 2452. View that a Conversion of Certificate is a Conversion of the Shares. — This view has been assented to by the Supreme Court of the United States in a case in which, in giving the opinion of the court, Waite, C. J., said: "It is true that the certificate of stock is not the stock itself; but it is documentary evidence of title to stock, and may be used for the purposes of symbolical delivery, as the stock itself is incapable of actual delivery. A blank indorsement of a certificate may be filled up by writing an assignment and power of attorney over the signature indorsed, and in this way an actual transfer of the stock on the books of the corporation may be perfected. A wrongful

[1] Ayres *v.* French, 41 Conn. 142, 151.

[2] Daggett *v.* Davis, 53 Mich. 35; *s. c.* 51 Am. Rep. 91; 18 N. W. Rep. 548.

use of such an indorsed certificate for such a purpose may operate as a conversion of the stock."[1]

§ 2453. **The Same View Under the Codes.** — Under the modern codes of procedure, where the forms of action are abolished and where only the substantial right of recovery in the form prayed for is considered, these trivial distinctions do not arise, or if they arise they are very summarily disposed of. Thus, while it is conceded in California that at common law trover lay only for tangible property, yet it is held that, under the code of procedure of that State, the action has been developed into a remedy for the conversion of other species of property; and it is accordingly held, in an action for the conversion of shares of stock, that it is the *shares of stock* which constitute the property of the stockholder, and not the certificate; and that an action is maintainable for the conversion of the shares of stock which the certificate represents as well as for the conversion of the certificate.[2]

§ 2454. **There may be a Conversion of the Certificate though not of the Shares.** — It has also been pointed out by an eminent judge that there may be a conversion of the certificate which does not carry with it the conversion of the stock, and this may be so under either of the foregoing theories. Thus, a certificate may stand in the name of the plaintiff, and may not be indorsed with the blank power of attorney so as to be capable of transfer, and in this form may be held by the defendant. The defendant, so holding it, cannot make it available to procure a transfer of the stock to himself on the books of the corporation, and he cannot therefore make it available to deprive the plaintiff of his title to the shares; but he may nevertheless deprive the plaintiff of the paper which is the plaintiff's muniment of his title, and hence he may be liable to the plaintiff for the conversion of this

[1] McAllister *v.* Kuhn, 96 U. S. 87, 89.

[2] Payne *v.* Elliot, 54 Cal. 339; *s. c.* 35 Am. Rep. 80. See also Fromm *v.* Sierra Nevada Silver Mining Co., 61 Cal. 629. So held in Utah under a code similar to that of California. Kuhn *v.* McAllister, 1 Utah, 275; *s. c.* affirmed, 96 U. S. 87. So held under the code of Nevada, which is modeled after that of California. Boylan *v.* Huguet, 8 Nev. 345.

paper and consequently for whatever damages the plaintiff may sustain thereby. "Conversion," said Cooley, C. J., in the reasoning by which he reached this conclusion, "does not necessarily imply a complete and absolute deprivation of property; there may be a deprivation which is only partial and temporary and where the property of the plaintiff remains in or is restored to him.[1] An illustration is where one hires a horse for one use and puts it to another, subsequently returning it to the owner.[2] The difference between such a case and one in which the property is wholly made away with is one affecting the damages only; the damages go to the whole value of the property in one case, and are commonly less in the other.[3] There may, therefore, have been a technical conversion in this case, though no use was made of the certificate." [4]

§ 2455. Trover Lies for the Conversion of Stock Certificates. — Whatever doubts may exist as to whether an action in the nature of trover will lie for the conversion of shares of stock, considered as ideal property, there is no doubt that the paper certificate of the shares is a valuable muniment of title, and hence is tangible property for which trover will lie, even under the early theory of an action of trover which rested on the fiction of a loss and a finding.[5]

[1] Citing Liptrot *v.* Holmes, 1 Kelly, 381, 391; Fisher *v.* Kyle, 27 Mich. 454; Hall *v.* Corcoran, 107 Mass. 251; *s. c.* 9 Am. Rep. 30.

[2] Citing Homer *v.* Thwing, 3 Pick. (Mass.) 492; Rotch *v.* Hawes, 12 Pick. (Mass.) 136; *s. c.* 22 Am. Dec. 414; Crocker *v.* Gullifer, 44 Me. 491; *s. c.* 69 Am. Dec. 118; Horsley *v.* Branch, 1 Humph. (Tenn.) 199.

[3] Citing Wheelock *v.* Wheelwright, 5 Mass. 104; Long *v.* Lamkin, 9 Cush. (Mass.) 361; Reynolds *v.* Shuller, 5 Cow. (N. Y.) 323; Cook *v.* Loomis, 26 Conn. 483; Brady *v.* Whitney, 24 Mich. 154, 156.

[4] Daggett *v.* Davis, 53 Mich. 35; *s. c.* 51 Am. Rep. 91; 18 N. W. Rep. 548, 550.

[5] Anderson *v.* Nicholas, 28 N. Y. 600; Atkins *v.* Gamble, 42 Cal. 86, 98; *s. c.* 10 Am. Rep. 282; Morton *v.* Preston, 18 Mich. 60, 72; *s. c.* 100 Am. Dec. 146. It was pointed out by McKee, J., in Payne *v.* Elliott, 54 Cal. 339, *s. c.* 35 Am. Rep. 80, that trover lies for *bank notes*, sealed in a letter. Moody *v.* Keener, 7 Port. (Ala.) 218. For negotiable instruments. Comparet *v.* Burr, 5 Blackf. (Ind.) 419. For a judgment. Hudspeth *v.* Wilson, 2 Dev. (N. C.) 372; *s. c.* 21 Am. Dec. 344. For a *promissory note* which has been paid. Pierce *v.* Gilson, 9 Vt. 216. For *copies* of a creditor's *account*. Fullam *v.* Cummings, 16 Vt. 697. For a *writ of execution* issued on a judgment. Keeler *v.* Fassett, 21 Vt. 539; *s. c.* 52 Am. Dec. 71. It seems that book accounts cannot be the subject of a con-

§ 2456. View that Trover Lies only for the Certificate — not for the Shares. — The Supreme Court of Pennsylvania, on the other hand, do not regard the distinction as unsubstantial or technical, and they accordingly deny that trover will lie to recover damages for the conversion of shares of corporate stock. The court, speaking through Mr. Justice Sharswood, characterize a share of stock as "an incorporeal intangible thing." "It is," said he, "a right to a certain proportion of the capital stock of a corporation — never realized except upon the dissolution and winding up of the corporation — with the right to receive in the meantime such profits as may be made and declared in the shape of dividends. Trover can no more be maintained for a share of the capital stock of a corporation than it can for the interest of a partner in a commercial firm. The two cases are precisely analogous. But the document or writing which is the evidence of ownership is a tangible and corporeal thing — the subject not only of property but possession — the right to which is essential in trover. Thus, a bond or promissory note may be the subject of an action, but not the debt of which it is the evidence."[1] It follows, under this theory, that a declaration containing a count for the conversion of seventy shares of the value of $100 each, will be bad on demurrer; though if it also contains a count for the conversion of *bonds* sufficiently described that count will be good;[2] and so no doubt would a count for the conversion of so many stock *certificates*, of such or such a value.

§ 2457. Right of Action of Member of Voluntary Association against Subsequent Corporation for Refusing Certificates of Shares. — Where a voluntary association is incorporated, on such terms that the associates become entitled to a proportion-

version. Kreher *v.* Mason, 33 Mo. App. 297. In Louisiana a corporation is liable for the damages caused by the *wrongful cancelling of a certificate* of its stock by its president and secretary. Factors &c. Ins. Co. *v.* Marine Dry Dock &c. Co. 31 La. An. 149. That trover will not lie against the estate of a decedent for stock which has been pledged to the decedent and sold by a special administrator, see Von Schmedt *v.* Bourn, 50 Cal. 616.

[1] Neiler *v.* Kelley, 69 Pa. St. 403, 407; citing and following Sewall *v.* Lancaster Bank, 17 Serg. & R. (Pa.) 285.

[2] Neiler *v.* Kelley, 69 Pa. St. 403, 407.

ate share of the stock of the corporation, if the corporation refuses to issue to an associate his proportion, he may maintain an action at law therefor by analogy to the right of action which exists in behalf of an assignee of shares against a corporation which refuses to transfer the shares to him on its books.[1]

§ 2458. **Not Necessary to Show Interest by Formal Ascertainment.** — In such an action, where the holders of shares in a voluntary association which had become incorporated, sued the corporation for refusing to admit them to their rights as shareholders, it was held not necessary for the plaintiff to allege and prove that he or his assignor was the actual holder of the stock according to the books of the company, that is, the voluntary association, or that he or his assignor had such an interest by ascertainment made at the time of the acceptance of the act of incorporation as that in respect of which he sues, — the reason being that such an ascertainment of interest is not a condition precedent to the organization of the company.[2]

§ 2459. **Plaintiff must have Right of Immediate Possession.** — In order to sustain an action of conversion, the plaintiff must have the right to immediate possession of the thing for which he brings his action. "He must undoubtedly have the immediate right to the thing itself, or else he would not have the right to recover its value *in præsenti*, any more than a man would have the right to recover on a note which is not yet due. If he has not this right, the conversion of the thing has not yet done the plaintiff any harm."[3]

§ 2460. **Demand and Refusal.** — This right to immediate possession must exist until there has been a demand and refusal; for until then the holding of the certificate by the defendant may have been in subordination to the rights of the plaintiff,— as where the defendant holds as the plaintiff's agent. In such cases unless a demand and refusal precede the commencement of

[1] Baltimore City Pass. R. Co. *v.* Sewell, 35 Md. 238; *s. c.* 6 Am. Rep. 402; Compare Rio Grande Cattle Co. *v.* Burns, 82 Tex. 50; *s. c.* 17 S. W. Rep. 1043.

[2] Baltimore City Pass. R. Co. *v.* Sewell, 35 Md. 238; *s. c.* 6 Am. Rep. 402, 408.

[3] Ayres *v.* French, 41 Conn. 142, 150.

the action, it ought not to be sustained, in the absence of statutes otherwise providing; for the defendant has done no wrong to the plaintiff at the time of the commencement of the action.[1] But clearly he may, in any view, exonerate himself by bringing the certificates into court and tendering them immediately after action commenced. It has been held that a demand for a certificate of shares of corporate stock and a refusal to deliver it may not of themselves constitute a conversion but they may be evidence of the conversion to go to the jury.[2] It has also been said that a demand, by the assignee of shares, upon the corporation for a transfer of the shares, is not equivalent to a demand of access to the books of the corporation for the purpose of making such transfer, and does not tend to prove a conversion of the shares;[3] but this seems too great a refinement.

§ 2461. **Must Tender Amount of Company's Lien.** — If the company has a lien on the stock, that of course must be satisfied before the stockholder can *insist* upon a transfer;[4] and if the company claim more than is really due at the time the transfer is demanded the stockholder must tender what he admits to be due, to put the company in the wrong for refusing to transfer.[5]

§ 2462. **Doctrine that Assumpsit Lies against the Corporation.** — There is a class of cases which hold that where the corporation refuses to register upon its books a transfer of its shares, upon the demand of the transferee, and to issue to him a new certificate therefor where such new certificate is required by its charter or by-laws, he has an action of *assumpsit* against the

[1] *Ante*, § 2437.

[2] Daggett *v.* Davis, 53 Mich. 35; *s. c.* 51 Am. Rep. 91; 18 N. W. Rep. 548, 550. See Thompson *v.* Rose, 16 Conn. 71; *s. c.* 41 Am. Dec. 121; Dent *v.* Chiles, 5 Stew. & P. (Ala.) 383; *s. c.* 26 Am. Dec. 350; Houston *v.* Dyche, Meigs (Tenn.), 76; *s. c.* 33 Am. Dec. 130; Sturges *v.* Keith, 57 Ill. 451; Hawkins *v.* Hoffman, 6 Hill (N.Y.), 586; *s. c.* 41 Am. Dec. 767; Davis *v.* Buffum, 51 Me. 160; Farrar *v.* Rollins, 37 Vt. 295; Huxley *v.* Hartzell, 44 Mo. 370; Lander *v.* Bechtel, 55 Wis. 593; *s. c.* 13 N. W. Rep. 483; Mechanics Banking Association *v.* Mariposa Co., 3 Robt. (N. Y.) 395.

[3] Purchase *v.* New York Exchange Bank, 3 Robt. (N. Y.) 164, per Robertson, C. J.

[4] *Ante*, § 2332.

[5] Pierson *v.* Bank of Washington, 3 Cranch C. C. (U. S.) 363.

corporation for the breach of the implied agreement that upon such a transfer it will discharge such duty to the transferee upon his request.[1] The doctrine of implied assumpsit, like other legal fictions, has no sound place in an enlightened system of jurisprudence. A rule of law which implies the existence of a contract where none has been made is not only nonsense in itself, but is entirely unnecessary to the doing of justice.

§ 2463. **Special Action on the Case.**— It seems that for the breach of this duty by a corporation actions of assumpsit and *case* have been indifferently maintained; and there are circumstances where, according to the views of the judges, the latter is the proper form of action at common law.[2] One court has reasoned that, although a shareholder who has transferred his shares in pledge, has not, after making such transfer, such legal title as will enable him to maintain trover against the pledgee for an unauthorized sale, he may maintain a special action on the case; and a count in case may be added to the complaint in trover by amendment.[3] But this is on the conception that the legal title passes to the pledgee, which, as elsewhere seen,[4] is not the usual view. But these distinctions become immaterial, in those jurisdictions where all the common law forms of action are abolished by the modern codes of procedure.

§ 2464. **Parties.**— Where the corporation negligently cancels the certificates of a shareholder and issues new certificates to another person, the true owner may pursue the corporation without making such other person a party to the suit,[5] or may proceed

[1] Kortright *v.* Commercial Bank, 20 Wend. (N. Y.) 91; *s. c.* in error, 22 Wend. (N. Y.) 348; *s. c.* 34 Am. Dec. 317; Sargent *v.* Franklin Ins. Co., 8 Pick. (Mass.) 90, 98; *s. c.* 19 Am. Dec. 306. *Contra*, Telford &c. R. Co. *v.* Gerhab, 21 Am. & Eng. Corp. Cas. 471; *s. c.* 13 Atl. Rep. 90; 3 Rail. & Corp. L. J. 439.

[2] Mechanics' Bank *v.* New York &c. R. Co., 13 N. Y. 599, 624; Nelson, J. Kortright *v.* Commercial Bank, 20 Wend. (N. Y.) 91; Protection Life Ins. Co. *v.* Osgood, 93 Ill. 69; Telford &c. Turnp. Co. *v.* Gerhab, 21 Am. & Eng. Corp. Cas. 471; *s. c.* 13 Atl. Rep. 90; 3 Rail. & Corp. L. J. 439; Morgan *v.* Bank of North America, 8 Serg. & R. (Pa.) 73, 87; *s. c.* 11 Am. Dec. 575.

[3] Nabring *v.* Mobile Bank, 58 Ala. 204.

[4] *Post*, § 2619.

[5] St. Romes *v.* Levee Steam Cotton Press Co., 127 U. S. 614; Baker *v.* Wasson, 53 Tex. 150.

against both.[1] In Louisiana a stockholder may sue the corporation alone for the value of his stock, illegally transferred; or he may contest the title of the transferee contradictorily with both.[2]

§ 2465. Not Necessary to Plead Consideration.— Where the declaration in such an action avers an assignment under seal or a delivery of the certificates of stock, the court will, on a motion in *arrest of judgment, presume* that the assignment was made for a *bona fide* consideration, and that the jury so found. The court seem to have been of opinion that the declaration would not have been bad on demurrer because it did not aver that the assignment was for a valuable consideration.[3]

§ 2466. Evidence in Such Actions: Presumption of Title in the Case of a Transfer in Blank.— A purchaser from one, other than the original stockholder, who receives a certificate of stock with the usual assignment and power of attorney thereon, executed in blank by said stockholder, in an action against the corporation for refusal to transfer the stock on its books, is not bound to show affirmatively the title of his immediate transferor. The *presumption* is that the stock was transferred and certificate delivered in *the course of business*, in the absence of evidence to the contrary.[4]

§ 2467. Not Necessary to Show Authority of President to Permit Transfers.— A corporation has been held thus liable for a wrongful refusal by its president to permit a transfer of stock to be made to one entitled to have it made, without proof of a valid delegation of authority to the president, where he has been in the habit of permitting transfers, or where the corporation has ratified his acts. In so holding, Chancellor Walworth said: "An individual who is bound to make a formal demand, is not obliged to hunt up the directors of a corporation for the purpose of having some one appointed who is authorized to comply with his legal demand. It is sufficient for him to apply at the

[1] Baker *v.* Wasson, 53 Tex. 150.

[2] Woodhouse *v.* Crescent Mut. Ins. Co., 35 La. An. 238.

[3] Baltimore City R. Co. *v.* Sewell, 35 Md. 238; *s. c.*, 6 Am. Rep. 402, 408.

[4] Holbrook *v.* New Jersey Zinc Co., 57 N. Y. 616.

bank during the usual hours of business, and make his demand upon the officers and clerks, who may be in attendance there; and in case they are not authorized to transact that particular business, they must either refer him to the proper officer in the bank, or procure the attendance of such officer, or of the board of directors, if necessary, without unreasonable delay. The transferring the shares of the capital stock on the books of a bank, is a matter of ordinary occurrence; and in the absence of any proof to the contrary, it may be fairly presumed that the principal officer or clerk in attendance at the bank, during the usual hours of business, is authorized to permit such transfer, when proper. * * * The charter of the bank in the present case, having authorized the owners of stock to sell and transfer it on the books of the corporation, it is the duty of the directors to see that some proper officer of the institution, usually in attendance at the bank, is duly authorized to allow such transfer when proper, to be made; and it is no excuse to say that they have neglected that duty, or, that when a demand was made at the bank, the persons in attendance there neglected to inform the person making the demand, who was the officer or clerk to whom that particular duty had been assigned." [1]

§ **2468. Not Necessary to Prove Fraud or Collusion: Negligence Sufficient.**— Where the plaintiff is suing for damages for the wrongful act of the corporation in permitting his shares to be transferred to some one else, it is not necessary, in order to charge the corporation, that its officers should have been guilty of *fraud* or *collusion*, but it is sufficient that they have failed to exercise *reasonable care*.[2]

[1] Commercial Bank *v.* Kortright, 22 Wend. (N. Y.) 348, 351; *s. c.* 34 Am. Dec. 317.

[2] Loring *v.* Salisbury Mills, 125 Mass. 138; Lowry *v.* Bank, Taney (U. S.), 310; Bayard *v.* Farmers' &c. Bank, 52 Pa. St. 232; Atkinson *v.* Atkinson, 8 Allen (Mass.), 15; Shaw *v.* Spencer, 100 Mass. 382; *s. c.* 97 Am. Dec. 107; Fisher *v.* Bram, 104 Mass. 259; *s. c.* 6 Am. Rep. 235; Duncan *v.* Jaudon, 15 Wall. (U. S.) 165. See also Hodges *v.* Planters' Bank, 7 Gill. & J. (Md.) 306, 310; Albert *v.* Savings Bank, 1 Md. Ch. 407.

Article X. Measure of Damages for Refusing to Transfer.

§ 2471. Measure of Damages: Value, Dividends, Interest. — The measure of damages in such actions, is (1) the *value* of the shares at the time of the refusal of the officers of the company to register the transfer;[1] (2) the *dividends* accrued thereon at that time; (3) with *interest* to the date of trial,[2] or in some States (and this is the better rule), to the date of judgment.[3] The general rule as to the measure of damages in an action of trover is the value of the goods at the time of the conversion, to which may be added interest up to the time of the trial, unless there were some special circumstances of outrage in the case, when the jury are at liberty to give more;[4] and this may be laid down as the general rule where the subject of the conversion is shares of stock in a corporation. Where the company wrongfully transfers the plaintiff's shares on its books to some one

[1] Sargent *v.* Franklin Ins. Co., 8 Pick. (Mass.) 100; *s. c.* 19 Am. Dec. 306; St. Louis Perpetual Ins. Co. *v.* Goodfellow, 9 Mo. 150, 155; Baltimore City Pass. R. Co. *v.* Sewell, 35 Md. 238; *s. c.* 6 Am. Rep. 402; Hussey *v.* M. & M. Bank, 10 Pick. (Mass.) 415; Parsons *v.* Martin, 11 Gray (Mass.), 111, 116.

[2] Baltimore City Pass. R. Co. *v.* Sewell, 35 Md. 238; *s. c.* 6 Am. Rep. 402.

[3] Hussey *v.* M. & M. Bank, 10 Pick. (Mass.) 415.

[4] Neiler *v.* Kelley, 69 Pa. St. 403, 408; Jacoby *v.* Laussatt, 6 Serg. & R. (Pa.) 300; Dennis *v.* Barber, *Id.* 420; Berry *v.* Vantries, 12 *Id.* 89; Taylor *v.* Morgan, 3 Watts (Pa.), 333; Harger *v.* McMains, 4 Watts (Pa.), 418; Weld *v.* Oliver, 21 Pick. (Mass.) 559; Pierce *v.* Benjamin, 14 Pick. (Mass.) 361.

else, the conversion takes place at the date of the transfer and the measure of damages is the value of the stock at that time.[1]

§ **2472. Price of Such Shares in the Market.** — Where the plaintiff had sold his shares and was unable to deliver them because of the company's refusal to make the transfer on its books, and, in order to make his contracts good, he was obliged to buy other shares,—it was held, by the English Court of Appeal, that the price which he was compelled to pay for such shares to fill his orders was the proper measure of damages, in an action against the company for refusing to transfer.[2]

§ **2473. Highest Market Value between Time when Delivery was Due and Date of Trial.** — But this rule has been modified to this extent, that wherever there is *a duty or obligation* devolved upon the defendant to *deliver* corporate stocks or other securities *at a particular time*, and this duty or obligation has not been fulfilled, then the plaintiff is entitled to recover the highest price in the market between that time and the time of the trial.[3] "The grounds of this exception," said Sharswood, J., "are that such securities are limited in quantity — are not always to be obtained at any price, and are of a very fluctuating value.[4] * * * We agree that in trover, where there has been actual conversion by a wrongful sale of the pledge, there is no necessity for a tender of the debt, but its amount may be recouped by the jury from the damages — the value at the time of conversion — but where the plaintiff seeks to fasten a responsibility for more than the usual measure of damages, he must also fasten upon the defendant the duty or obligation to deliver specifically the stocks or securities, at some particular time, and their refusal to fulfill that duty. *Non constat* that upon a demand and tender the defendants would not have been able to deliver to the plaintiff similar stocks and securities, as, according to Gilpin *v.* Howell,[5] they might well do."[6]

[1] Mobile &c. R. Co. *v.* Humphries (Miss.), 7 South. Rep. 522.

[2] Tomkinson *v.* Balkis Consolidated Co. (1891), 2 Q. B. 614.

[3] Neiler *v.* Kelley, 69 Pa. St. 403, 408. See also Bank of Montgomery *v.* Reese, 26 Pa. St. 143; Reitenbaugh *v.* Ludwick, 31 Pa. St. 131.

[4] Neiler *v.* Kelley, 69 Pa. St. 403, 408.

[5] 5 Pa. St. 41.

[6] Neiler *v.* Kelley, *supra.*

§ 2474. Amount Sold for, in Excess of Par Value. — Where a shareholder sued a corporation for a conversion of his shares, and it appeared that the corporation had made a *call* for the entire amount due in respect of the plaintiff's subscription for the shares, and that, the plaintiff not having responded to the call, the corporation had proceeded in a manner not authorized by the governing statute, to *forfeit* the shares, and to this end they had been sold, after being advertised for five consecutive weeks in a weekly newspaper of large circulation and had brought $200 in excess of their aggregate par value,—it was held that the trial court did not err in entering a judgment in favor of the plaintiff for $200. The court said: "In this case, these shares were encumbered by an assessment equal to their par value; that is, the purchase price of those shares for which the plaintiff was indebted to the defendant corporation. That sum must, in any event, be paid to the defendant if the shares would bring it upon the market. The findings show that they did bring that sum and $200 more, and that, of the proceeds of the sale, $10,000 were applied in satisfaction of plaintiff's debt to the defendant corporation. What effect these proceedings had upon the plaintiff's right to the stock in question, we can not now consider, because the question is not involved here. All that we now decide is that, under these findings, the sale of the plaintiff's stock was irregular and unauthorized, and that the court below did not err as to the measure of damages under the peculiar facts of this case." [1]

§ 2475. Lost Dividends. — It has been reasoned that dividends on stock correspond to the *hire* of property. The purchaser of railroad stock from an administrator, at an unauthorized private sale, is liable in equity to the distributees of the estate to which the stock belonged, for all damages resulting directly from the *conversion*, including, besides the value of the shares, the consequent *loss of dividends* with interest thereon. The dividends to be treated as lost are all those innocently paid by the corporation, after the illegal purchase and up to the time of the decree, whether paid to the purchaser himself, or to those

[1] Budd *v.* Multonoma St. R. Co., 15 Ore. 413; *s. c.* 3 Am. St. Rep. 169, 175; *s. c.* on former appeal, 12 Ore. 271; 53 Am. Rep. 355.

holding under him, immediately or remotely, by regular transfer.[1]

§ 2476. **For the Conversion of a Stock Certificate.** — We elsewhere notice a distinction taken by some courts between the conversion of a share certificate and a conversion of the shares themselves,—holding that the former may be the subject of a conversion and hence of an action of trover, while the latter can not.[2] The doubtful nature of this distinction will appear in view of the holdings to the effect that the measure of damages is the same in both cases. As the certificate is the shareholder's evidence of his title, a conversion of it generally operates to deprive him of his title; and hence, in an action of trover against one who has converted it, the measure of damages is the same as in an action of trover for the conversion of *title deeds;* and this according to English authority is the full value of the property of which the paper is the plaintiff's muniment of title.[3] Reasoning from these analogies, it has been held that in trover for the conversion of a certificate of corporate stock, the plaintiff is entitled to recover the market value of the stock, as shown by evidence, at the time of the conversion.[4] In short, where the possession of the certificate is necessary to the possession and enjoyment of the shares, the measure of damages is not the value of the paper on which the certificate is printed, nor anything else than the value of the shares of which the paper is the muniment of title, and for the possession and enjoyment of which property the paper is necessary.[5]

§ 2477. **Continued: Actual Damages, and not Value of Shares, Recoverable.** — Where the case is one of the conversion of the certificate merely, and not of the conversion of the

[1] Nutting *v.* Thomasson, 57 Ga. 418.

[2] *Ante*, § 2451, *et seq.*; *post*, § 2642, *et seq.*

[3] Parry *v.* Frame, 2 Bos. & Pul. 451. See also Clowes *v.* Hawley, 12 Johns. (N. Y.) 484. Thus, it is said in a work of reputation: "In trover for title deeds, the jury give the full value of the estate to which they belong, by way of damages, which, however, are generally reduced to 40 shillings on the deed being given up." Mayne Dam. (Woods Am. ed.), p. 497.

[4] Connor *v.* Hill, 11 Rich. L. (S. C.) 193, 195.

[5] Morton *v.* Preston, 18 Mich. 60; *s. c.* 100 Am. Dec. 146.

shares represented thereby, as where the shares continue to stand in the name of the plaintiff, and the defendant continues wrongfully to hold possession of the scrip certificate, though unable to make use thereof to effect a transfer of the shares to himself,—the measure of damages of the plaintiff will obviously be limited to the loss he actually suffers, which loss is not necessarily the value of the shares.[1]

§ **2478. For Wrongful Sale of Shares by Pledgee.** — Where the pledgee of shares wrongfully sells them, and a bill in equity is prosecuted by the pledgor to redeem them, if the circumstances are such that the pledgor must take alternative relief in the form of damages, he will be entitled to charge the defendant with the value of the shares at the time of filing the bill, on the theory that the defendant is bound to place him in as good a condition as he could have occupied if the unlawful conversion had not taken place; in other words, he must either replace the shares,

[1] Daggett *v.* Davis, 53 Mich. 35; *s. c.* 51 Am. Rep. 91; 18 N. W. Rep. 548. In giving the opinion of the court in this case, Cooley, C. J., says: "There are some cases in which trover has been brought for instruments which were rather the representatives of property than property itself, in which a recovery has been allowed to the full value of the property; but nearly every case has stood upon its own facts and is easily distinguishable from the present." He then proceeded to distinguish Parry *v.* Frame, 2 Bos. & Pul. 451, where, in trover for a *lease*, the plaintiff recovered the full value of the term, it appearing that he had made arrangements with the landlord which amounted to an appropriation of the term. Also Clowes *v.* Hawley, 12 Johns. (N. Y.) 484, where, in trover for a *title bond* executed by the defendant, the plaintiff recovered the value of the land, to which he was entitled under the bond, the defendant remaining the owner of it. Also Coombe *v.* Sampson, 1 Dowl. & R. 201, where in trover for *title deeds* a verdict for £2,500 damages was allowed, but as a means of compelling the wrongful possessor of the deeds to surrender them to the owner, an order being entered for the reduction of the judgment to such a sum as would indemnify the plaintiff for his actual damages, upon the deeds being restored. Also Connor *v.* Hillier, 11 Rich. L. (S. C.) 193, where a recovery was allowed for the full value of the stock represented by the *shares* which had been converted, the report not showing that the conversion of the *certificate* did not deprive the plaintiff of his legal title to the shares. Also Nelson *v.* King, 25 Texas, 655, which seems to resemble the last case in its main facts. See also to the same effect Mowry *v.* Wood, 12 Wis. 413, where the subject of the conversion was a certificate of *land scrip* issued by the State, where the plaintiff was restricted to actual damages.

or pay enough money for his wrong to enable the pledgor to replace them.[1]

§ 2479. Measure of Damages for Conversion of Stock by Broker. — By a rule in New York, where the broker has converted the stock of his principal, by selling the same without notice or contrary to the terms of the agreement, the principal will be entitled to recover, in an action for the conversion, *what it would have cost him to replace the stocks* on a day *within a reasonable time after the sale*, deducting the sum due to the broker, in the dealings between the parties, — such day being not subsequent to the commencement of the action.[2] By the rule in Illinois, the measure of damages is the value of the stock at the time of the conversion, with interest from that date until the date of the trial.[3] By the rule in Nevada, it is the value of the stock at the time of the conversion, with interest from the conversion to the judgment, together with any special damage which may legitimately arise out of the matter in existence at the date of the tort; and it is there held that the highest market value between the date of the conversion and the trial is not the correct measure of damages.[4]

[1] Fowle *v.* Ward, 113 Mass. 548; *s. c.* 18 Am. Rep. 534. Compare Sewell *v.* Boston Water Power Co., 4 Allen (Mass.), 277; *s. c.* 81 Am. Dec. 701; Emery *v.* Parrott, 107 Mass. 95.

[2] Baker *v.* Drake, 53 N. Y. 211; *s. c.* 13 Am. Rep. 507; 8 Alb. L. J. 340 (overruling on this point Markham *v.* Jaudon, 41 N. Y. 235). The rule of damages stated in the text was reaffirmed in Baker *v.* Drake, 66 N. Y. 518; *s. c.* 23 Am. Rep. 80; and in Colt *v.* Owens, 90 N. Y. 368. See also Harris *v.* Tumbridge, 83 N. Y. 92, 100; *s. c.* 38 Am. Rep. 398.

[3] Sturges *v.* Keith, 57 Ill. 451; *s. c.* 11 Am. Rep. 28.

[4] Boylan *v.* Huguet, 8 Nev. 345. The subject may be further pursued by examination and a comparison of the following authorities: 2 Greenl. Ev., §§ 276, 649; Sedgw. Dam. 492; Shepherd *v.* Johnson, 2 East, 211; McArthur *v.* Seaforth, 2 Taunt. 257; Downes *v.* Back, 1 Stark. 318; Harrison *v.* Harrison, 1 Carr. & P. 412; Greening *v.* Wilkinson, 1 Carr. & P. 625; Mercer *v.* Jones, 3 Camp. 477; Smith *v.* Dunlap, 12 Ill. 184; Pinkerton *v.* Manchester &c. R. Co., 42 N. H. 424; Sleuter *v.* Wallbaum, 45 Ill. 43; Keaggy *v.* Hite, 42 Ill. 99; Otter *v.* Williams, 2 Ill. 118; Yater *v.* Mullen, 24 Ind. 277; Suydam *v.* Jenkins, 3 Sandf. (N. Y.) 629; Baltimore Marine Ins. Co. *v.* Dalrymple, 25 Md. 272; Walker *v.* Borland, 21 Mo. 289; State *v.* Smith, 31 Mo. 566, 572; Watson *v.* Harmon, 85 Mo. 443, 446; Eichelman *v.* Weiss, 7 Mo. App. 87, 89; Stevens *v.* Springer, 23 Mo. App. 375, 385; Kennedy *v.* Whitwell, 4 Pick. (Mass.) 466; Lillard *v.* Whitaker, 3 Bibb (Ky.), 92; Watts *v.* Potter,

§ **2480. In Case of Failure of Broker to Deliver.**— The measure of damages of the principal for the failure of a broker to deliver the shares is the market value of the shares at the time of the breach by the broker of his contract to deliver, with legal interest, as damages for the detention of such value; he is not liable for the highest market price between the time of the conversion and the day of trial, on the theory that he is withholding from the plaintiff certain specific shares which he has purchased for the plaintiff and to which the plaintiff is entitled.[1]

§ **2481. Where the Broker Neglects to Close a "Straddle" for His Principal.**— Where a person bought, through the agency of a broker, a stock option or privilege, known in the slang of such transactions as a "straddle," which secured to the holder the right to demand of the seller, at a certain price, within sixty days, a certain number of shares of a specified stock, or to require him to take, at the same price, within the same time, the same number of shares of the same stock, and the broker the next day sold the stock "short" against the "straddle," and the principal sued him for damages for his unauthorized and negligent act,— it was held that the plaintiff was entitled to recover what she had lost by the defendant's neglect, and, the price of the stock from day to day through the period of the option having been shown, it was for the jury to determine the amount.[2]

2 Mason (U. S.), 77; Dillenback *v.* Jerome, 7 Cow. (N. Y.) 294; Conrad *v.* Pacific Ins. Co., 6 Pet. (U. S.) 268; State *v.* McKeon, 25 Mo. App. 667, 676.

[1] Boylan *v.* Huguet, 8 Nev. 345, 354. There is, however, a difference of opinion upon this question. See St. Peters Church *v.* Beach, 26 Conn. 356; Page *v.* Fowler, 39 Cal. 412; Matthews *v.* Coe, 49 N. Y. 57; Suydam *v.* Jenkins, 3 Sanf. S. C. (N. Y.) 614. Several cases hold that if the stock has risen in value since the day when it should have been delivered, the price at the time of trial is to be the measure of damages. Shepherd *v.* Johnson, 2 East, 211; McArthur *v.* Seaforth, 2 Taunt. 257; Downes *v.* Back, 1 Stark. 318; Harrison *v.* Harrison, 1 Carr. & P. 412; Owen *v.* Routh, 14 C. B. 327. Compare O'Meara *v.* North American Mining Co., 2 Nev. 113; Prescott *v.* Wells, 3 Nev. 82; Carlyon *v.* Lannan, 4 Nev. 156; Bowker *v.* Goodwin, 7 Nev. 135; Greening *v.* Wilkinson 1 Carr. & P. 625; Archer *v.* Williams, 2 Carr. & Kir. 27; Shaw *v.* Holland, 15 M. & W. 145; Gainsford *v.* Carroll, 2 Barn. & C. 624; Mercer *v.* Jones, 3 Camp. 477; Elliott *v.* Hughes, 3 Fost. & Fin. 387.

[2] Harris *v.* Tumbridge, 83 N. Y. 92; *s. c.* 38 Am. Rep. 398. See also *post*, § 2709.

§ **2482. Corporation Not Liable for Subsequent Depreciation.**— A corporation failing or refusing to transfer stock on its books, at the request of a pledgee, is not liable for subsequent depreciation of the stock.[1]

§ **2483. Nominal Damages Only for a Technical Conversion.**— The rule which makes the measure of damage the value of the shares at the time of their conversion (or a reasonable time thereafter, as some of the courts hold),[2] is said to be subject to exceptions, one of which is that, where the plaintiff has suffered only a *technical conversion*, without any actual pecuniary loss, only nominal damages can be recovered.[3] Thus, if a broker, without notice to his principal, closes by sale certain stocks which he has purchased for his principal on a margin, this, it is held, is a conversion of them; but if the price which they bring is their market value on the day of sale, and if they continue to depreciate, and finally settle and remain permanently at a much lower price,— the customer has lost nothing, unless indeed he bought them for some other purpose than either speculation or investment; and he could not plead the conversion in bar of an action by the broker for indemnity for the loss sustained by him in the transaction.[4]

ARTICLE XI. FIDUCIARY RELATION BETWEEN COMPANY AND STOCKHOLDER.

§ **2486. Corporation a Trustee for its Shareholders for the Protection of their Title.**— A corporation is a trustee for its shareholders for the purpose of protecting their titles to their

[1] Dayton Bank *v.* Merchants' Bank, 37 Oh. St. 208.

[2] *Ante*, § 2479.

[3] Budd *v.* Multonoma St. R. Co., 15 Ore. 413; *s. c.* 3 Am. St. Rep. 169, 174.

[4] Gruman *v.* Smith, 81 N. Y. 25.

shares, and to this end it is bound to exercise reasonable care and diligence, and is consequently responsible to a shareholder who has lost his title to his shares through its neglect or misconduct.[1] This principle has been more fully stated thus: "A corporation, whose stock is transferable only on the books of the company, is made the custodian of the shares, and is clothed with power to protect the rights of its shareholders from unauthorized transfers. With this power there exists the duty that rests upon all trustees, to protect, so far as the exercise of proper diligence and care can do so, the interests of the *cestuis que trust;* and it must respond in damages for any injury sustained in consequence of its negligence or misconduct."[2] This well settled doctrine must be regarded either as an important qualification or as a denial of the principle frequently stated in judicial decisions that a corporation does not stand in any fiduciary relation to its stockholders.[3]

[1] Perry on Trusts, § 242; Mora. Corp., § 237; Caulkins *v.* Gaslight Company, 85 Tenn. 683; *s. c.* 4 Am. St. Rep. 786, 793; 4 S. W. Rep. 287; Lowry *v.* Bank, Taney (U. S.), 310; Bayard *v.* Farmer's Bank, 52 Pa. St. 232; Stewart *v.* Firemen's Ins. Co., 53 Md. 564; Loring *v.* Salisbury Mills, 125 Mass. 150; Shaw *v.* Spence, 100 Mass. 382; Duncan *v.* Jaudon, 15 Wall. (U. S.) 165; Covington *v.* Anderson, 16 Lea (Tenn.), 314; Supply Ditch Co. *v.* Elliott, 10 Colo. 327; *s. c.* 3 Am. St. Rep. 586, 591; 15 Pac. Rep. 691; Atkinson *v.* Atkinson, 8 Allen (Mass.), 15; Pennsylvania Railroad Co.'s Appeal, 86 Pa. St. 80; Albert *v.* Savings Bank, 1 Md. Ch. 407; Hodges *v.* Planters' Bank, 7 Gill & J. (Md.) 306.

[2] Caulkins *v.* Gaslight Co., 85 Tenn. 683, 696; *s. c.* 4 Am. St. Rep. 786, 794, opinion by Folkes, J.

[3] It is said in a case in New York: "The corporation does not stand in any fiduciary relation to its stockholders; * * * the stockholders are in no sense creditors of a corporation, nor are they in the situation of partners. They are constituent parts of the corporation." Karnes *v.* Rochester &c. R. Co., 4 Abb. Pr. (N. S.) (N. Y.) 107, 110. In an earlier case in the same State it was said by Vice-Chancellor McCoun: "The corporation is merely the creature of the law, a political body, not a natural body, made up of the compact entered into by the stockholders, each of whom become the corporators identified with and forming a constituent part of the corporate body; and therefore when we speak of stockholders and the incorporated company of which they are the components, we refer to one and the same collection of persons. How, then, can the relation of trustee and *cestui que trust* exist, for such a relation requires separate and distinct persons or separate and distinct bodies to constitute it." Verplanck *v.* Mercantile Ins. Co., 1 Edw. Ch. (N. Y.) 85, 87. In a recent case in the Superior Court of New York City, it is said by Sedgwick, C. J.: "It is true that the corporation is something more than its trustees and shareholders; but its

§ 2487. Duty of Corporation as Trustee for its Shareholders.— The duty of a corporation toward those interested in the transfer of the shares of its stock has been thus stated: It is "made the custodian of the shares of stock, and clothed with power sufficient to protect the rights of every one interested, from unauthorized transfers; it is a trust placed in the hands of the corporation for the protection of individual interests, and, like every other trustee, it is bound to execute the trust with proper diligence and care, and is responsible for any injury sustained by its negligence or misconduct."[1] It is said that "in all such cases there may be no actual fault on the part of the corporation, yet the principle results from the justice and expediency, in such transactions, of casting the loss on those who can best provide against it."[2]

§ 2488. Responsibility Assumed by the Corporation in Discharging this Trust. — The responsibility assumed by the corporation in discharging this trust cannot be stated in a paragraph: this and the two following articles are devoted entirely to its discussion. In the exercise of this duty, the corporation is, on the one hand, bound to protect the shareholder in whose name the shares stand on its books from the loss of his legal title by a wrongful transfer; and, on the other hand, to make, or permit to be made on its books, a transfer to one who has acquired the rights of the holder in whose name the shares stand thereon, except where other rights intervene, as elsewhere discussed. The former duty, it is perceived, is negative; the latter is affirmative. It is liable in damages to the person injured for its failure to perform either of them. It may be further stated that here, as elsewhere, the corporation can act only through agents,

property, chattels, money and choses in action it owns, not in its own interest, but for the pecuniary benefit of the natural persons connected with it. It would be impossible to look upon the property rights of the corporation merely having regard to its being an ideal creature. It acts through natural persons. It acts for the benefit of natural persons. In truth, natural persons compose it. The statute under which it was formed says this." Parsons *v.* Hayes, 14 Abb. N. C. (N. Y.) 419, 430.

[1] Lowry *v.* Commercial &c. Bank, Taney (U. S.), Dec. 310; Cleveland &c. R. Co. *v.* Robbins, 35 Oh. St. 483, 500.

[2] Cleveland &c. R. Co. *v.* Robbins, *supra;* Chew *v.* Bank of Baltimore, 14 Md. 300.

and that if a loss is sustained through the act of the proper officer of the corporation touching a transfer of its shares, the corporation, in the absence of fraud or collusion, practiced against it, must bear the loss, and it cannot be put upon the transferee.[1] As the corporation appoints the officers before whom the transfers of stock must be made, it is responsible for their acts, and must answer for their negligence or default, whenever the rights of a third person are concerned.[2] To illustrate this duty and liability, it may be observed that the corporation does not act with proper care and diligence if it admits a transfer to registry, and issues a new certificate without the *surrender* of the old one, unless the loss or destruction of the old one is proved, and even then it seems that the corporation is entitled to a bond of indemnity.[3] If, therefore, its officers, through neglect, issue a new certificate to a supposed transferee without requiring the old certificate to be surrendered, the corporation becomes liable in damages to a *bona fide* transferee of such new certificate.[4] It is not valid as a stock certificate, on principles elsewhere discussed,[5] but it stands in the hands of the innocent transferee as an evidence of his right to indemnity against the corporation for what he has lost through its neglect. So, where the signatures to *powers of attorney* for transfer were genuine, but at the time of the transfer were *thirteen years old*, the corporation was *put on inquiry*, and was bound, before making the transfer, to ascertain whether the powers had been revoked.[6]

§ 2489. Liable for Permitting Wrongful Transfers. — Let us first consider its liability for permitting a wrongful transfer, whereby the legal title of the true owner is divested. This liability arises where the corporation permits one who is agent of another to transfer the shares of his principal to himself on its books, without proper authority from his principal, — in the particular case, with no other authority than a general power of

[1] Hodges *v.* Planters' Bank, 7 Gill & J. (Md.) 306; Albert *v.* Savings Bank, 1 Md. Ch. 407.

[2] Lowry *v.* Commercial &c. Bank, Taney (U. S.), 310.

[3] *Post*, § 2520.

[4] Supply Ditch Co. *v.* Elliot, 10 Colo. 327; *s. c.* 3 Am. St. Rep. 586; 15 Pac. Rep. 691.

[5] *Ante*, §§ 1493, 2044.

[6] Pennsylvania R. Co.'s Appeal, 86 Pa. St. 80; Bayard *v.* Farmers &c. Bank, 52 Pa. St. 232.

attorney authorizing him to sell and transfer stock and other securities and property, the share certificates not being indorsed by his principal;[1] and where a corporation, knowing that certain *stock is held in trust*, aids the trustee in converting it to his own use, by changing and re-issuing stock certificates, and making transfers on its books;[2] or (in Louisiana) where the corporation without a mandate "express and special," within Art. 2997 of the Civil Code, has permitted a transfer of a stockholder's stock.[3] And, in general, if a person gets possession of the certificates of shares of another, under circumstances which do not constitute him the owner, or put him under the protection of the rule relating to *bona fide* purchasers for value, the corporation will be liable to the real owner in an action for damages for the conversion of its shares, if its officers transfer the shares on the corporate books to the supposed owner. The governing principle is that the owner of property cannot be deprived of it without his consent, except by due process of law.[4]

§ **2490. Liable for Restricting Rightful Transfers.** — Subject to exceptions which are elsewhere considered,[5] a corporation subjects itself to liability for damages to a shareholder, whenever it undertakes to obstruct the rightful transfer of its shares on its books. The following language of a very capable judge expresses clearly the grounds of this liability: "In the absence of any requirements in the charter or by-laws restricting the transfer, the company must make a transfer on its books or it will be liable to the purchaser. There is no presumption in favor of the right of a corporation to refuse to transfer on its books stock of the company which the shareholder has sold to a *bona fide* purchaser. The certificate represents the property, and if any secret lien upon the property exists, such lien must be shown. The burden is on him who asserts the peculiar privilege to prove it, as restrictions on the free transfer of personal

[1] Tafft *v.* Presidio &c. R. Co., 84 Cal. 131; *s. c.* 18 Am. St. Rep. 166; 24 Pac. Rep. 436 (decided under Civ. Code Cal., § 324).

[2] Caulkins *v.* Memphis Gaslight Co., 85 Tenn. 683; *s. c.* 4 Am. St. Rep. 786; *post*, § 2528, *et seq.*

[3] Woodhouse *v.* Crescent Mut. Ins. Co., 35 La. An. 238.

[4] Telegraph Company *v.* Davenport, 97 U. S. 369.

[5] *Ante*, § 2332.

property are not favored, especially as against an innocent purchaser who has paid for the certificate. At common law and independently of positive provisions of the legislation granting or authorizing the exercise of the power, a corporation cannot prohibit the transfer of its shares on account of the indebtedness of the shareholder to the corporation. Where the stock is personal property, the restrictions upon its transfer must have their source in legislative action, and the corporation itself cannot create these impediments."[1] A mere *notice* to the officers of the company, from parties having a beneficial interest in the stock sought to be transferred, that the right of the party having the legal title to make the transfer is questioned and will be contested, will not justify the officers in a persistent refusal to make the transfer, after a *reasonable and sufficient time* has elapsed to enable the parties giving the notice to institute legal proceedings to contest the right to make the transfer.[2] It has been held that the fact that certificates of stock, purporting to be *fully paid*, have been inadvertently issued to subscribers who had paid but two-thirds of their subscriptions, and that the secretary of the corporation has been ordered by the directors to call in and cancel such certificates, does not justify him in refusing to transfer on the books of the corporation shares purchased from one of such subscribers. Nor is it material whether the sale of the stock was *bona fide* or not, since the purchaser in such a case becomes responsible for whatever remains unpaid in respect of the shares.[3] To this statement of doctrine it ought to be added by way of caution, that other courts have held that where a corporation issues unpaid stock as fully paid up it thereby *estops itself*, as against an innocent purchaser for value, from claiming that anything remains unpaid in respect of them.[4]

[1] Carroll *v.* Mullanphy Savings Bank, 8 Mo. App. 249, 252, opinion by Hayden, J. The court cite: Chouteau Spring Co. *v.* Harris, 20 Mo. 387; Moore *v.* Bank, 52 Mo. 377; Bank of Attica *v.* Manufacturers Bank, 20 N. Y. 505; Rosenback *v.* Bank, 53 Barb. (N. Y.) 495; Steamship Dock Co. *v.* Heron, 52 Pa. St. 280; Sargent *v.* Insurance Co., 8 Pick. (Mass.) 90; *s. c.* 19 Am. Dec. 306. See Bullard *v.* Bank, 18 Wall. (U. S.) 598.

[2] State *v.* McIver, 2 S. C. 25.

[3] Herdegen *v.* Cotzhausen, 70 Wis. 589.

[4] *Ante*, § 1630, *et seq.*

ARTICLE XII. ITS LIABILITY FOR WRONGFUL TRANSFERS.

§ 2493. Liability of Corporation for Transferring on a Power by One Non Sui Juris. — We shall see[1] that the rule is that where a corporation recognizes a power of attorney to transfer shares on its books, it *takes the risk of its validity*, just as a banker takes the risk of the validity of the signature of the check which it pays. Under this view, the corporation is therefore liable in case it permits a transfer under a power of attorney which is either *forged*,[2] or executed by an *infant*, a *married woman*, or a *lunatic*.[3] The reasoning is that the corporation may refuse to recognize the power of attorney, if not satisfied of its entire genuineness, and may require the personal

[1] *Post*, § 2556.

[2] *Post*, § 2556, *et seq*.

[3] Chew *v*. Bank of Baltimore, 14 Md. 299. Under recent enabling statutes a *married woman* is now undoubtedly capable of making a power of attorney to transfer shares belonging to her, in the usual way.

attendance of the party for the purpose of determining such matters of fact as may give rise to disputes. On the premise that the corporation possesses this power, the court held that a bill of sale of stock, with a power of attorney for its transfer, *executed by a lunatic*, may be avoided by the lunatic in a proceeding instituted for that purpose, and the bank held responsible for allowing the transfer to be made under such a power, although there may be no actual fault on the part of the bank.[1]

§ 2494. Motives for Transferring when not Examinable.— Where the parties to the transfer of corporate shares comply with the conditions which give them the legal right to have the transfer made on the books of the company, the officers of the corporation are under no duty to inquire into the *motives* of the transfer, nor can they refuse to make the transfer on the books of the corporation because they may think that the motives of the parties are improper, or that the transfer may injuriously affect the interests of that or of some other company: their duties are merely *ministerial and clerical*, and they have no judicial power to pass upon the validity of the reasons which induce the parties to demand the transfer.[2] But, as elsewhere seen,[3] the operation of this rule ceases where the corporation has *notice of the equitable rights of third persons* in the shares, in fraud of which the transfer is attempted to be made. Another *exception to this principle* has been admitted, to the effect that the person demanding the transfer of the shares on the books of the company has conspired with others and entered into an arrangement whereby the shares were to be indorsed and delivered to him, apparently and professedly for value, but really without any consideration, so as to enable him to acquire the ownership and control of the corporation to the exclusion of all other persons interested therein, — the person demanding the transfer being an agent of one of that species

[1] Chew *v.* Bank of Baltimore, 14 Md. 299. In this case the transfer of stock under a bill of sale and power of attorney executed by a lunatic, was avoided, and it was adjudged, that the bank should pay simple interest on the dividends accrued on the stock since the transfer, from the time the bank knew of the lunacy.

[2] Re Klaus, 67 Wis. 401; *s. c.* 29 N. W. Rep. 582; 29 Am. L. Reg. (N. S.) 98; State *v.* McIver, 2 S. C. 25.

[3] *Post*, § 2528.

of combination known as a "trust" for the control of corporations, — the officers of the corporation will be justified in resisting the transfer.[1]

§ 2495. Transfers to Effect Collateral Purposes will nevertheless be upheld, where the purposes are *not unlawful*, and where the transfer is out-and-out; for, in the absence of any right of lien on the part of the corporation, the right of alienation being absolute, it does not lie in the mouth of the corporation, or of any one else, to question the *motive* of the parties to it.[2] This will be the rule in the case of an out-and-out transfer made for the purpose of enabling the transferee to vote at a corporate election.[3] It has been so held where the object of the transfer was to enable the transferee to become a party to an action.[4] But such an effect will not be ascribed to a transfer where it appears that it was a sham, and that there was no real change in ownership.[5]

§ 2496. Whether Blank Transferee must Satisfy Corporation that he is a Genuine Purchaser. — It has been held by the Supreme Court of New York that where, by the terms of the charter of a corporation, recited on its stock certificates, its

[1] Gould *v.* Head, 41 Fed. Rep. 240; *s. c.* 7 Rail. & Corp. L. J. 402. Compare *s. c.* 38 Fed. Rep. 886.

[2] See preceding section, and *ante*, § 2303.

[3] *Ante*, § 2303. It has been held that if a party purchases of a bank a large amount of stock to increase the number of votes he is entitled to throw, makes use of them for that purpose, and, immediately thereafter, the directors return the purchase money and resume the stock, a court of equity will not compel the purchaser to refund the money and take back the stock, where the proof shows that no injury has resulted from the transaction. Taylor *v.* Miami Exporting Company, 6 Ohio, 176.

[4] Stock was transferred to A. on the day of the commencement of an action to set aside sales made by the corporation, in order that A. might join in the action. The money with which the purchase was made was placed to A.'s credit by the person who wanted him to join, and the shares were not transferred on the books of the corporation. It was held (Davis, P. J., dissenting) that the transfer carried title to A., and that he was properly a party to the action. Erwin *v.* Oregon Ry. & Nav. Co., 35 Hun (N. Y.), 544.

[5] A transfer of bank stock to citizens of the State, by a non-resident holder, for the purpose of enabling them to vote, under the statute, without any real change in the ownership, does not, according to one holding, make the transferees legal voters. State *v.* Hunton, 28 Vt. 594.

stock can only be transferred on its books by the stockholder or his attorney, the corporation is under no obligation to permit a transfer to be made to a person claiming to be the assignee of a certificate, on the mere presentation of such certificate, with an assignment and power of attorney executed by the original holder in blank, no person being named or specified as the assignee or attorney; and moreover, that an action of assumpsit can not be maintained against the bank, for refusing to permit such transfer, without proof by the plaintiff, that he had purchased the certificate, and was the owner thereof.[1] But this decision is believed to be contrary to all sound business or legal conceptions on the subject. As we shall more fully see,[2] the possession of a certificate thus indorsed, is *prima facie* evidence of ownership, in such a sense as enables the holder to confer upon an innocent purchaser in many cases a better title than he himself may have; and the general rule is that an intending purchaser is not required to look beyond the certificate to the books of the company.[3] Such evidence ought to be received by the officers of the corporation, and also in a court of justice, in an action of assumpsit, as *presumptive evidence* of the right of the holder to have the transfer made to him; since right-acting, and not wrong-acting, is presumed by the law. But as the corporation is a trustee for its shareholders in respect of preserving the title to their shares,[4] it would obviously be justified in refusing to make a transfer to one coming with one of its share certificates indorsed in blank, and with a blank power of attorney, where there were circumstances exciting reasonable suspicions of his right to have the transfer made to him. Its officers clearly would not be bound to record the transfer if they knew, or had reasonable ground to believe, that he had obtained the certificate by an act in the nature of larceny or involving a breach of trust. The true view, upon which nearly all the cases unite, is that the holder of a certificate of shares of stock, with an irrevocable power of attorney from the owner to transfer them, is *presumptive equitable owner*, and if shown to be a holder for value without notice, his title cannot be impeached, although the attorney's name

[1] Dunn *v.* Commercial Bank of Buffalo, 11 Barb. (N. Y.) 580.

[2] *Post*, § 2595.

[3] *Post*, § 2599.

[4] *Ante*, § 2486.

is in blank; that such a power of attorney may be filled up and executed, by any one of several successive *bona fide* holders, whenever his interests may require it; and that the *power* is neither *exhausted* by its first use, nor *revoked* by the maker's death, nor affected by passing through any number of hands, until its execution by an actual transfer.[1] As he is presumptively the equitable owner, the corporation cannot, before permitting a transfer to him of the shares on its books, put him to further proof of his title, without first producing evidence impeaching it.

§ 2497. Corporation not a Guarantor of Shareholder's Title. — As already indicated,[2] it is sometimes held that the measure of duty of the corporation is *good faith* and *reasonable care and diligence;* and that, in the absence of fraud or collusion on the part of its officers charged with the duty of protecting the title of the shareholder, the mere transfer of stock on the books thereof, by direction of the vendor to his vendee, does not make the company liable as a guarantor of the vendor's title to the stock.[3]

§ 2498. "Certification" of Shares. — In conformity to this principle, a "certification" of shares by an officer of the company, according to a practice which has sprung up upon the English Stock Exchange, has been held to amount to no more than a representation that the transferor has produced to the person certifying such documents as are apparently in order, and as show on the face of them a *prima facie* title in the transferor to transfer the shares mentioned in the transfer; it does not warrant the title of the transferor, nor the validity of the various documents which establish his title. It does not, therefore, estop the company from afterwards denying title to one who purchases shares on the faith of such a certification, or give him an action against it for a careless misrepresentation.[4] This practice of procuring "certifications" from the secretary of the company has arisen from the difficulty experienced by members of the English Stock

[1] Leavitt *v.* Fisher, 4 Duer (N. Y.), 1; Mt. Holly Tp. Co. *v.* Ferree, 17 N. J. Eq. 117; Tatman *v.* Lobach, 1 Duer (N. Y.), 354.

[2] *Ante*, § 2487.

[3] Central R. Co. *v.* Ward, 37 Ga. 515. But see *post*, § 2556.

[4] Bishop *v.* Balkis &c. Co., 25 Q. B. Div. 512; *s. c.* 9 Rail. & Corp. L. J. 127, 31 Am. & Eng. Corp. Cas. 342; aff'g. *s. c.* 25 Q. B. Div. 77; *s. c.* 8 Rail. & Corp. L. J. 466.

Exchange in settling their accounts as buyers and sellers of shares, where the seller's certificate of title does not accompany his transfer. If the seller's certificate includes more shares than he sells, he does not deliver it to the buyer with the transfer, but the seller produces his certificate and the transfer to an officer of the company, and he "certificates" the transfer; and buyers and brokers act on the faith of this "certification," just as they do if the certificate produced to the company had been produced to and lodged with themselves. No fee is paid for a "certification." In every case the "certification" must be read in connection with the transfer on which it is put. The object of the certification is to enable the transferor to satisfy his transferee that he, the transferor, can make a good title to the shares mentioned in the transfer. This he can only do if he is himself the registered owner of the shares mentioned in the transfer, or if he has a transfer from the registered owner to himself, or to some one through whom he claims by a transfer or series of transfers. The "certification," therefore, to be of any use at all, must amount to a *representation* that the transferor has produced to the certifying officer such documents as, on the face of them, show a *prima facie* title in the transferor to transfer the shares mentioned in the transfer; or, in other words, that the transferor has produced to the person certifying, either what purports to be a certificate of the title of the transferor to the shares mentioned in the transfer, or the equivalent of such documents, — what purports to be a certificate of the title of some one else to those shares, and one or more documents purporting to transfer those shares, from such persons to the transferor. Such is a description of the English practice of "certification" as given by Lindley, L. J., in his opinion in the case just cited, with which Lord Esher, M. R., and Bowen, L. J., concurred. Then he continued to state the reasons of the conclusions of the Court of Appeal as follows: "The evidence in this case shows that the certification does mean this. But the certification means no more, nor can it reasonably be supposed to mean more. The certification is made by the secretary or some other officer, who has no time to do more than look at the documents produced to him. If, in business language, they are, 'in order,' *i. e.*, if they are right on the face of them, he certifies; if they are not, he refuses to certify. But he has no means of ascertaining and no time to inquire whether the documents produced to him are genuine or not, nor whether the various transfers are valid or invalid in point of law. He acts on what he sees, and there is no pretense for saying that he does more or is understood by business men to do more. He does not warrant the title of the transferor, nor the validity in point of law of the various documents which may establish

his title. That this is the true view of the effect of a certification will be apparent, if it is remembered that certifications are sometimes made by an officer on the stock exchange, and not by any officer of the company, the shares of which are the subject of the transfer." [1] The learned justice then proceeded to reason that the company is undoubtedly bound by the act of its officer in making such a "certification," and is estopped to deny the truth of the facts certified, either expressly or by necessary implication. But the decision of the court turned upon the inquiry as to what those facts were, — in other words, as to the real meaning of such a certification, as appears from the language already quoted.

§ 2499. Right of Corporation to Refuse Substitution of Assignee until Subscription Paid. — As the subscription to the capital stock creates a *debt* against the stockholder in favor of the corporation, this substitution of a transferee so as to release the transferor, cannot, it has been held under the language of a statute, take place without the sanction of the corporation.[2] But the power of the corporation to refuse to register the assignment and issue certificates to the assignee until the assignor has paid any unpaid balance due on his subscription, is believed to depend upon the terms of the charter or governing statute. The principle, however, remains that the mere assignment of a subscriber of his shares will not relieve him from liability to the corporation in respect of any unpaid balance due thereon until the assignee is regularly substituted in his place on the books of the corporation.[3] But this does not solve the question whether the corporation can refuse its assent to the assignment, or whether the assignee will not be entitled to the usual remedies to compel such assent or to recover damages of the corporation for its refusal to give such assent, on the theory of a conversion of his shares.

§ 2500. Costs Given for Unreasonably Refusing to Register. — Where a corporation unreasonably refuses to transfer shares of stock, unless under a decree of a court, costs will be decreed against it.[4]

[1] *Ibid.*, 25 Q. B. Div., pp. 519, 520.

[2] Graff *v.* Pittsburgh &c. R. Co., 31 Pa. St. 489; Everhart *v.* Philadelphia &c. R. Co., 28 Pa. St. 340; Pittsburgh &c. R. Co. *v.* Clarke, 29 Pa. St. 146.

[3] Burke *v.* Smith, 16 Wall. (U. S.) 390, 400.

[4] Iasigi *v.* Chicago &c. R. Co., 129 Mass. 46.

§ 2501. Corporation should Refuse Transfer unless Certificate Surrendered.— Where certificates are outstanding representing shares of stock, it is the duty of the corporation to resist any transfer of such shares on its books, without the production and surrender of the certificates; and any act done or suffered by the corporation which invests a new party with the ownership of the shares, without the due production and surrender of the certificate, renders the corporation liable to the real owner of the shares for their conversion.[1] "Any transfer of stock by a corporation upon its books, in the absence of the original certificate, is made at its peril, and the real owner of the stock, evidenced by such certificate, loses nothing thereby; but upon the stock so issued by wrong or mistake, the corporation is liable to a *bona fide* holder thereof.[2] It has accordingly been held that a bank whose certificates of stock entitle the stockholder upon their face to so many shares, which are transferable on the books, by attorney or in person, when the certificates are surrendered, but not otherwise, and which allows a stockholder to transfer his stock, on the books of the bank, without producing and surrendering his certificates, is liable to a *bona fide* transferee for value of the same stock, who produces the certificates with properly executed power of attorney to transfer, and this although no notice has been given to the bank of the transfer.[3] The reason is that already stated with reference to the nature of stock certificates, that they are a continuing affirmation by the corporation of the title of the person therein named to the number of shares therein named. It is within the scope of the authority of the officer of the corporation charged with the duty of recording the transfer, of receiving the old and issuing the new certificate, to bind the corporation by this representation in the new certificate.[4]

[1] Smith *v.* American Coal Co., 7 Lans. (N. Y.) 317; Miller, J., in Cushman *v.* Thayer &c. Man. Co., 76 N. Y. 365; *s. c.* 32 Am. Rep. 315, 319. See also New York &c. R. Co. *v.* Schuyler, 34 N. Y. 83; Davis *v.* Bank, 2 Bing. 393; Pollock *v.* Bank, 7 N. Y. 274; Cohen *v.* Gwynn, 4 Md. Ch. 357; Re Bahia &c. R. Co., L. R. 3 Q. B. 584; Donaldson *v.* Gillot, L. R. 3 Eq. 274; Sewall *v.* Boston &c. Co., 4 Allen (Mass.), 277; Strange *v.* Houston &c. R. Co., 53 Tex. 162; Bank *v.* Lanier, 11 Wall. (U. S.) 369; Hall *v.* Rose Hill &c. Road Co., 70 Ill. 673.

[2] Supply Ditch Co. *v.* Elliott, 10 Colo. 327; *s. c.* 3 Am. St. Rep. 586, 592.

[3] Bank *v.* Lanier, 11 Wall. (U. S.) 369.

[4] It is held to be within the apparent

§ **2502. Illustrations.** — It follows that if the *equitable owner* of shares of corporate stock which are outstanding in the name and possession of a third person, who claims them as absolute owner, makes demand of the company for the transfer and delivery of them, but without returning to it the certificates, and it refuses to comply with this demand, such equitable owner cannot maintain an action against the company and the legal holder for the value of the stock.[1] Upon this state of facts it was observed by McIlvaine, J.: "The defendant was a railroad corporation whose corporate property consisted of a railway and other valuable interests. This corporate property was held by the company in trust for the benefit of its stockholders. The plaintiff was an equitable stockholder, and as such, had a resulting beneficiary interest in the corporate property, and was entitled to all the rights and privileges of a corporator. The defendant had no power of control over the stock of the plaintiff except as to the mode and manner of transferring the legal title. The legal title, or, in other words, the certificates of the plaintiff's stock, the primary evidence of this ownership, was in the name and possession of another party who claimed to be the absolute owner thereof. The books of the company coincided with the evidence of the certificates, and made a *prima facie* case against the claim of the plaintiff. Now, can it be that, because the defendant refused to assume the peril of deciding between the contending claimants, by issuing their certificates for the same stock to the plaintiff upon demand, that it thereby became a wrong-doer and converted the plaintiff's stock to its own use, and rendered itself liable to respond in the full value of the stock to the claimant who could establish his right in a court of law? The mere statement of the proposition refutes it."[2] - - - The owner of stock in a corporation put his certificate, with an executed transfer in blank upon it, into the hands of an agent, for the purpose of effecting a sale. The agent filled in the transfer and made sale, and transferred the certificate to A., who purchased in good faith and for value. The original owner of the stock sold it to B. for a valuable consideration, B. also purchasing it in good faith, and without notice of A.'s rights, but without acquiring possession of the certificate, and the stock was transferred to B. upon the corporation

authority of the secretary of a corporation, not only to issue new stock certificates on the surrender of old ones, but also impliedly to represent, by the issuance of the new certificates, that the old ones have been surrendered. Cincinnati &c. R. Co. *v.* Citizens Nat. Bank (Super. Ct. Cin.), 24 Ohio L. J. 198. Compare Bishop *v.* Balkis Consol. Co., 25 Q. B. Div. 512; *s. c.* 31 Am. & Eng. Corp. Cas. 342; 8 & Rail. *v.* Corp. L. J. 466.

[1] National Bank *v.* Lake Shore &c. R. Co., 21 Ohio St. 221.

[2] *Ibid.*, p. 232.

books, and a new certificate issued to B. The certificates issued by the corporation contained a clause to the effect that they were transferable by assignment, and that a new certificate would be issued upon the surrender of the old one. A by-law of the corporation provided that transfers might be made either upon the certificate or upon a separate paper, and that upon presentation of the transfer "with the certificate" a new certificate should be issued. It was held that the corporation was liable to A. for damages for the conversion of his shares.[1]

§ 2503. New Certificates Issued without Taking up Original Ones, Invalid. — If the secretary of a corporation issues new share certificates without taking up and cancelling the original certificates, the new certificates will be invalid,[2] except as the foundation of a claim for indemnity against the corporation under the principle elsewhere stated.[3]

§ 2504. Certificate Need not be Presented in Order to Draw a Dividend. — But where the holder of a certificate stands on the books of a corporation as the registered owner of the shares, it is not necessary for the protection of the corporation, in paying to him a dividend which has been declared, that he should produce to the corporation his certificate. The corporation is in such a case entitled to go by its own record, in the absence of notice of anything impeaching the title of him who on that record appears to be the owner of the shares.[4]

§ 2505. Transfers in Pursuance of a General Power of Attorney but without the Indorsement of the Owner. — It has been held that a general power of attorney authorizing an agent to sell, dispose of, transfer and deliver all or any of the interests of the principal in the capital stock of any association or body corporate, does not confer upon the agent the power to transfer *to himself* the shares of the principal in the shares of a cor-

[1] Strange *v.* Houston &c. R. Co., 53 Texas, 162.

[2] Hall *v.* Rose Hill &c. Co., 70 Ill. 673; Cincinnati &c. R. Co. *v.* Citizens Nat. Bank (Super. Ct. Cin.), 24 Ohio L. J. 198.

[3] But see *post*, §§ 2577, 2578.

[4] Brisbane *v.* Delaware &c. R. Co., 25 Hun (N. Y.), 438, citing Smith *v.* American Coal Co., 7 Lans. (N. Y.) 317; McNeil *v.* Tenth Nat. Bank, 46 N. Y. 325; *s. c.* 7 Am. Rep. 341; Manning *v.* Quicksilver Mining Co., 24 Hun (N. Y.), 360; *ante*, §§ 2172, 2180.

poration, or to transfer such shares except by an indorsement upon the certificate in the usual way for and in the name of the principal; and that, where the corporation, on the surrender of the share certificate by the agent, without any indorsement thereon, but upon the mere exhibition of this general power of attorney, issued to him in exchange therefor new certificates for an equal number of the shares of the corporation, it became liable to his principal for damages for the conversion of her shares. Nor could the corporation invoke the principle that where one of two innocent persons must suffer, the loss shall fall upon him who has afforded the opportunity for the commission of a wrong, because it was the corporation that afforded the agent the opportunity to inflict the wrong upon his principal and which aided him in so doing.[1]

§ 2506. Validity of a By-law Restraining Transfers except upon Surrender of Certificate, etc. — From what has preceded it is almost needless to say that a by-law of a corporation, providing that no shares of its stock shall be transferred on its books until the certificate has been surrendered to its president or shown to be lost, is valid and binding on all its stockholders and their heirs.[2]

§ 2507. Illustration of the Rule that a Transferee Demanding Recognition must Present his Certificate. — A good illustration of the rule that a transferee of a certificate of shares in a corporation, who demands recognition as a shareholder by the corporation and claims rights, against the corporation, in virtue of being one of its shareholders, must, in order to substantiate his demand, present his certificate, is found in a recent case in Colorado where the transferee of two shares in a ditch or water company demanded the number of inches of water to which he was entitled in virtue of being a holder of the two shares, but without communicating to the company the fact that he was such holder. It was held that, without communicating the fact to the company, he acquired as against them no right to the water, and that for taking the water without the consent of the company, on

[1] Tafft *v.* Presidio &c. R. Co., 84 Cal. 131; *s. c.* 18 Am. St. Rep. 166; 24 Pac. Rep. 436; reversing on rehearing 7 Rail. & Corp. L. J. 33; 22 Pac. Rep. 485. The question turned upon the interpretation of the power of attorney, but the statement of the text is offered as a fair summary of the decision.

[2] State *v.* Iberville Parish Judge, 30 La. An. Part I., 308.

the theory that he had become the owner of it, he was in fact a trespasser.[1]

§ 2508. Transfer under a Decree of Confiscation. — In a case arising in Georgia soon after the late civil war, it was held that where the complainants claimed title to fifty shares of railway stock, purchased from those who derived their title thereto under a judgment, and proceedings thereunder of the district court of the "Confederate States of America for the Southern District of Georgia," confiscating such stock as the property of citizens of another of the United States as being alien enemies,— that the purchasers of the stock did not acquire a valid title thereto so as to defeat the title of its original owners, and that the corporation could not be required to transfer to such purchasers a certificate of ownership of the stock on the books of the company.[2] - - - - Where shares in a corporation were sold by a United States marshal under a *decree of confiscation*, which was void because rendered in proceedings in which no notice had been given to the owner of the stock, and the corporation had denied the purchaser's title, and that purchaser had sold the stock to the plaintiff, — it was held, in an action of trespass on the case for the value, that the corporation was not liable to the plaintiff for the stock or unpaid dividends, the plaintiff having had such *notice* of the facts, before his purchase, as should have put him upon *inquiry*.[3]

§ 2509. Effect of Transfer by Order of Court to Purchaser at Sheriff's Sale. — When a judicial tribunal of last resort, after a *bona fide* contest by the corporation, has ordered stock to be transferred to a purchaser at a sheriff's sale, the corporation is not liable to the holder of the certificate of the stock, who took no steps to protect himself.[4]

§ 2510. Transferring a Fractional Part of a Share. — It seems that an action for damages will not lie against a corporation for refusing to transfer on its books a fractional part of a share, — as where three persons buy a share together, and one of them sues the corporation for the conversion of his interest.[5]

[1] Supply Ditch Co. *v.* Elliott, 10 Colo. 327; *s. c.* 3 Am. St. Rep. 586.

[2] Central Railroad &c. Co. *v.* Ward, 37 Ga. 515.

[3] Avil *v.* Alexander Water Co., 1 Hughes (U. S.), 408.

[4] Friedlander *v.* Slaughter House Co., 31 La. An. 523.

[5] Haegele *v.* Western Stove Man. Co., 29 Mo. App. 486. As to transferring a fractional portion of the shares represented in a single certificate, see *post*, § 2548.

§ 2511. Previous Transfer to Purchaser under Execution. — One who purchases shares of bank stock, expressed to be "transferable at the bank," has no action against the bank for refusing to transfer them to him on its books, where, previous to any notice by him to the bank, it had transferred them in good faith to one who had purchased them at a sale *on execution* against the person in whose name they stood on the corporate books.[1]

§ 2512. Injunction Restraining Transfer. — Where bank shares have been assigned by the owner, and the assignee seeks to have them transferred on the books of the bank, in accordance with a provision in its articles of association requiring the transfer to be so made, the bank is not liable to an action for refusing to allow such transfer to be made, where an injunction has been issued under § 294 of the New York Code of Civil Procedure, in *proceedings supplemental to execution* on judgment against the assignor, restraining the bank from making the transfer.[2]

§ 2513. Transfers Ordered by Probate Court. — Where the evidence tends to show that the plaintiff was entitled to a distributive share in an estate; that an order of the probate court directed the administrator to transfer certain corporation stock to the plaintiff in payment of such distributive share, and that the plaintiff afterwards refused to receive the stock and accepted other estate in lieu thereof, it is not error to instruct that, upon such a state of facts, the plaintiff cannot recover, in an action against the corporation to compel his recognition as a stockholder and for the conversion of his interest in the capital stock.[3]

Article XIII. Its Duties and Responsibilities Where Certificates Have Been Lost or Stolen.

[1] Williams *v.* Mechanics' Bank, 5 Blatchf. (U. S.) 59; *ante*, § 2400, *et seq.*

[2] Purchase *v.* New York Exchange Bank, 3 Robt. (N. Y.) 164.

[3] Haegele *v.* Western Stove Mfg. Co., 29 Mo. App. 486.

§ 2516. Rights of Owner Superior to those of Bona Fide Purchaser of Lost or Stolen Shares. — A certificate of stock in a private corporation, indorsed in blank by the person to whom it was issued, not being a negotiable instrument, and no custom or usage to the contrary among stock brokers being valid,[1] — if such certificate is lost, or stolen from the owner, without fault on his part, his right to it is superior to that of any person who may acquire it by purchase for value from any other holder; [2] and he may maintain, against the corporation and the person who holds the stolen scrip, an action to establish his right to it.[3] The same principle has been applied to bills of lading indorsed in blank.[4] It has been observed, with reference to this question, that "if the purchaser from one who has not the title, and has no authority to sell, relies for his protection on the negligence of the true owner, he must show that such negligence was the proximate cause of the deceit.[5]

§ 2517. Corporation Issues New Certificate at its Peril. — If the share certificate of a shareholder has been *lost*, and he or his alleged vendee claims of the corporation the issue of a new certificate, the corporation will issue it at its peril, and is, therefore, as elsewhere stated,[6] entitled to demand *indemnity* before making such new issue. This is well illustrated by a case in Ohio, where the following statement of fact and holding have been condensed from the official syllabus. In 1854, a railroad company issued to V. certificates of stock, declaring on their

[1] *Post*, §§ 2587, 2588.

[2] East Birmingham Land Co. *v.* Dennis, 85 Ala. 565; *s. c.* 2 L. R. A. 836; 5 South. Rep. 317; 28 Cent. L. J. 402; 5 Rail. & Corp. L. J. 296; Barstow *v.* Savage Mining Co. 64 Cal. 388; *s. c.* 49 Am. Rep. 705.

[3] Wells *v.* Smith, 7 Abb. Pr. (N. Y.) 261.

[4] Gurney *v.* Behrend, 3 El. & Bl. 622.

[5] Barstow *v.* Savage Mining Co., *supra;* quoted with approval in East Birmingham Land Co. *v.* Dennis, *supra.*

[6] *Ante*, § 2044.

face that the stock was transferable on the company's books on surrender. Soon afterwards V. sold the stock to F., delivering to F. the certificates with blank powers of attorney to enable him to have the stock transferred. The certificates were mislaid by F., and were not discovered until 1871. In 1863, on application of V., the directors issued to B., to whom V. assumed to sell the stock, new certificates, believing the original ones to have been lost by V. On the ground of such issuance, the company refused an application of F.'s administrators for a transfer of the stock to their names, and for an account of the dividends. The by-laws provided that no new certificates should be issued in place of any certificate previously issued, until its surrender and cancellation; also that certificates might be issued on the special order of the board of directors, in the place of certificates lost or destroyed, on proof of such loss or destruction, and on receiving security to indemnify the company against loss consequent upon the issuance of such new certification. On this state of facts it was held: 1. That the company was liable to replace the stock to which F. was entitled, or to account for its value. 2. That this liability to F. was not affected by the by-law enabling persons who had lost certificates to obtain new ones. 3. That the company was not liable for the dividends paid on the stock before it had notice of the transfer of the certificate to F. 4. That until the transfer of the stock to the holders of the original certificate was refused, or they had notice of the transfer of the stock to other parties, the statute of limitations did not begin to run.[1]

§ **2518. And Refuses Transfers to the Rightful Holder at its Peril.** — So, where, on a *false allegation* made to the corporation by a shareholder, that his share certificate has been *lost*, if the corporation refuses to admit a *bona fide* purchaser of such certificate to registration on its books, as a shareholder in respect of it, it equally proceeds at its peril. This is well illustrated by a case in Wisconsin, where L. assigned his certificate of stock in a railroad company, presented to the company an affidavit that he had lost it, and procured the issue of a new certi-

[1] Cleveland &c. R. Co. *v.* Robbins, 35 Ohio St. 483.

ficate in its stead, upon giving his bond "to save the company harmless from all loss by reason of said second issue, and from any liability on account of * * * the stock described in said affidavit." The railroad company thereupon refused to allow a transfer of the stock on its books when requested by the holder of the original certificate, and the stock depreciated so that it became worthless. It was held: 1. That an action on the case for such refusal lay against L. as well as against the railroad company. 2. (By majority of the court): That the bond was general assets of the company, and that the plaintiff could not have, by subrogation, a right of action in equity upon it.[1]

§ 2519. In Such a Case Vendor of Bona Fide Shareholder may be Liable together with the Corporation. — From the case just considered[2] we may extract the conclusion that if a shareholder sells his shares to a purchaser for value and in good faith, and afterwards, by means of a false affidavit of their loss, and a bond of indemnity, procures the corporation to issue new shares to him, and to refuse to admit to registration and to the rights of a shareholder his vendee,—the latter may have an action both against him and the corporation. The case falls within the well known rule that all who direct, request or advise an act to be done which is wrongful, are in themselves wrong-doers and responsible for all damages;[3] or, as more accurately stated, "that all who aid, command, advise or countenance the commission of a tort by another, or who approve of it after it is done, if done for their benefit, are liable in the same manner as they would be if they had done the same tort with their own hands;"[4] and, further, that every unlawful interference with, or assertion of control over the property of another, is sufficient to subject a party to an action.[5] In such a case the corporation is liable for the conversion of the shares of the member, as the direct and original wrong-doer, and the shareholder who has

[1] Greenleaf *v.* Ludington, 15 Wis. 558; *s. c.* 82 am. dec. 698.

[2] Greenleaf *v.* Ludington, 15 Wis. 558; *s. c.* 82 Am. Dec. 698.

[3] Beardsley, C. J., in Davis *v.* Newkirk, 5 Denio (N. Y.), 94.

[4] Judson *v.* Cook, 11 Barb. (N. Y.) 644.

[5] Wall *v.* Osborn, 12 Wend. (N. Y.) 39; Phillips *v.* Hall, 8 *Id.* 610; *s. c.* 24 Am. Dec. 108; Dreyer *v.* Ming, 23 Mo. 434.

thus induced the corporation to do the wrongful act is liable as its co-trespasser or co-tort-feasor; for in torts *simpliciter* all who participate are principals. Such a case sustains a close analogy to the principle that a party who requests a sheriff, or other levying officer, to do an act, or who indemnifies him for doing it, makes himself liable for damages if the act turns out to be wrongful.[1] Citing these authorities, and reasoning somewhat in this way, the Supreme Court of Wisconsin reached the conclusion above stated, and gave its own reasons therefor in the language of Dixon, C. J.: "It is impossible to distinguish between these cases and the one at bar. The refusal of the company to make the transfer resulted naturally and ordinarily from the giving of the bond of indemnity."[2]

§ 2520. Company may Demand Bond of Indemnity before Issuing New Certificate. — A bond of indemnity may be required by a corporation as a condition of issuing new certificates of stock for those that have been lost, where the owner is an assignee and has never had possession of the old certificates, and the lapse of time is not so great as to preclude danger of their reappearance.[3]

§ 2521. Doctrine that Company can not Refuse to Issue Certificates on Bond of Indemnity being Given. — There is an ill-considered and discredited case in Louisiana, which holds that where there is a *by-law* of the company providing that, in the case of the loss of the certificate, it must be *advertised* for a certain time, after which a new one may be issued upon the application of the shareholder, the giving of bond, etc., — if one claiming to have lost his certificate establishes, to the satisfaction of the court, the fact of the loss and of the advertisement required by the by-law, it can compel the company, by *mandamus*, to issue a new certificate without giving to it a bond of indemnity. The court could perceive no good reason for requiring such a bond. The judge who delivered the opinion said: "The stock can not be transferred by the railroad except upon the books of the respond-

[1] Davis *v.* Newkirk, *supra*; Judson *v.* Cook, *supra*; Root *v.* Chandler, 10 Wend. (N. Y.) 110: *s. c.* 25 Am. Dec. 546; Coats *v.* Darby, 2 N. Y. 517; Herring *v.* Hoppock, 3 Duer (N. Y.), 20; *s. c.* affd., 15 N. Y. 409.

[2] Greenleaf *v.* Ludington, 15 Wis. 568, 569; *s. c.* 82 Am. Dec. 698.

[3] Guilford *v.* Western U. Tel. Co., 43 Minn. 434 *s. c.* 46 N. W. Rep. 70; *ante*, § 2044.

ent and the production of the certificate."[1] The judge who wrote this opinion seems to have had no adequate understanding of the nature of stock certificates, or of the effect of their loss, or of the opportunities of a fraud in alleging and proving their loss.

§ 2522. Protecting the Company by Allowing the Cause to stand on the Docket. — In a case in Texas, which was a suit in equity by the alleged owners of *a lost* share certificate to establish their rights to the shares therein described, and which consequently depended for its decision upon the same principles as the preceding case, the court took a much more just and serious view of the injurious consequences which might flow to innocent persons from a false allegation of the loss of such a certificate, or from an improper use of it if it should be outstanding. The suit was tried in 1878, and it was made to appear that the shares had been issued to the ancestors of the plaintiffs in 1841, and that they still stood in his name on the books of the company. The District Court found that the certificate had been lost, and that the plaintiffs, as the heirs of the original owner, were the lawful owners of it. It was held that, in view of the fluctuating value of the stock, the uncertainty when it would be necessary to give a bond of indemnity in case the plaintiffs should seek to obtain exclusive control of their share in the stock, etc., of the company, and the number of the plaintiffs, — the case should remain open on the docket of the District Court, until it could be finally dismissed without prejudice to either party; that the plaintiffs should have the privileges of a stockholder, so long as no superior title to such certificate was set up, and should give the company a bond of indemnity against all loss in case such title should be established, and should also give other bonds whenever they should claim exclusive ownership of any of the capital stock.[2]

§ 2523. Statute of New York Giving Remedy for Procuring Duplicate Certificate in Case of Loss of Original. — A statute has existed in New York since 1873, giving a remedy to a shareholder who has lost his share certificate, for the purpose of compelling the corporation to issue to him a duplicate. This statute derives more than ordinary importance from the fact that it is found on the statute books of the greatest commercial State of the Union, and the State in which probably the greatest corporate interests are centered, and from the further fact that it seems already to have been adopted

[1] State ex rel. *v.* New Orleans Gas Light Co., 25 La. An. 413.

[2] Galveston City Co. *v.* Sibley, 56 Tex. 269. The decree, which is a long one, is set out in the report, 56 Tex. pp. 279–81.

by some of the other States. It is therefore thought expedient to set it out in full: "Whenever any company, incorporated under the laws of this State, shall have refused to issue a new certificate of stock in place of one theretofore issued by it, but which is alleged to have been lost or destroyed, the owner of such lost or destroyed certificate or his legal representatives may apply to the supreme court at any special term thereof appointed to be held in the judicial district where such owner resides, for an order requiring such corporation to show cause why it should not be required to issue a new certificate of stock in place of the one so lost or destroyed. Such application shall be by petition, duly verified by the owner, in which shall be stated the name of the corporation, the number and date of the certificate, if known, or can be ascertained by the petitioner, the number of shares of stock named therein, and to whom issued, and as particular a statement of the circumstances attending such loss or destruction as such petitioner shall be able to give. Upon the presentation of said petition, such court shall make an order requiring said corporation to show cause, at a time and place therein mentioned, why it should not be required to issue a new certificate of stock in place of the one described in said petition. A copy of said petition and of said order shall be served upon the president or other head of such corporation, or on the cashier, secretary or treasurer thereof, personally, at least ten days before the time designated in said order for showing cause.[1] At the time and place specified in said order, and on proof of due service thereof, the said court shall proceed, in a summary manner and in such mode as it may deem advisable, to inquire into the truth of the facts stated in said petition, and shall hear such proofs and allegations as may be offered by or in behalf of the petitioner, or by or in behalf of such corporation or other party relative to the subject-matter of such inquiry; and if, upon such inquiry, the said court shall be satisfied that such petitioner is the lawful owner of the number of shares of the capital stock or any part thereof, described in said petition, and that the certificate therefor has been lost or destroyed, and cannot after due diligence be found, and that no sufficient cause has been shown why a new certificate should not be issued in place thereof, it shall make an order requiring said corporation or other party, within such time as shall be therein designated, to issue and deliver to such petitioner a new certificate for the number of shares of the capital stock of said corporation which shall be specified in said order as owned by said petitioner, and the certificate for which shall have been lost or destroyed. In making such order the court shall direct that said petitioner deposit such security or file such

[1] New York Act of March 27th, 1873; Laws of N. Y. 1873, ch. 151, § 1.

a bond in such form and with such sureties as to the court shall appear sufficient to indemnify any person other than the petitioner who shall thereafter appear to be the lawful owner of such certificate stated to be lost or stolen; and the court may also direct the publication of such notice, either preceding or succeeding the making of such final order, as it shall deem proper. Any person or persons who shall thereafter claim any rights under said certificate so alleged to have been lost or destroyed, shall have recourse to said indemnity, and the said corporation shall be discharged of and from all liability to such person or persons by reason of compliance with the order aforesaid; and obedience to said order may be enforced by said court by attachments against the officer or officers of such corporation, on proof of his or their refusal to comply with the same."[1]

§ 2524. The Constitutionality of this Statute Doubtful.— An analysis of this statute will make its constitutionality appear more than doubtful. To illustrate this, let us suppose the case already cited from Ohio,[2] where a shareholder, who had sold his shares to a *bona fide* purchaser for value, went before the corporation, and, on satisfying it that he had lost them, and giving to it a bond of indemnity, procured it to issue new share certificates to him. The corporation became liable to his vendee for the conversion of his shares, and this on the most obvious grounds. It is perceived that the above statute contemplates only an adversary proceeding between the party alleged to have lost his share certificate and the corporation whose shares he has lost. In the case supposed, the third party who would be the equitable owner of the shares, would not be cited or notified and would not have his day in court, but his shares would be subjected to a judicial confiscation in a proceeding between two other parties, and he would be remitted to a bond of indemnity which might or might not be good. Such a disposal of his property without a notice and without a hearing, by a proceeding between two other parties, would be a taking of it without due process of law, and this would bring the statute within the inhibition of the fourteenth amendment to the constitution of the United States. It is easy to perceive how the shares of a shareholder residing in England, or in some more remote country, might be confiscated by a proceeding under this statute, and he remitted to a worthless bond of indemnity. It is believed that governmental power does not extend to the disposal of the rights of a person, — especially of an alien, — in this manner, without notice to him and without giving him any opportunity of being heard. It is perceived that no provision is made for

[1] *Ibid.*, § 2.

[2] *Ante*, § 2517.

the issue of any process, or for the publication of any notice, directed to any one who may be supposed to be a claimant of the shares as against the petitioner in the proceeding under the statute; and that the only notice provided for is such a notice by publication either preceding or succeeding the making of the final order, as the court shall deem proper, — that is to say, a notice in the mere *discretion* of the court. The statute seems to be aimed at the solution of a real difficulty, and one which has frequently arisen; but, in so far as it undertakes to dispose of the shares of an absent person and to remit him to a bond of indemnity, by a proceeding between *other parties*, it is believed to have no vadidity whatever.

§ **2525. Construction of this Statute.** — It has been held — and this is the obvious reading of the statute — that jurisdiction in the Supreme Court to make the order required by it, does not exist, unless three facts are established: 1. That the petitioner is the owner of the shares claimed to have been lost or destroyed. 2. That such shares have been lost or destroyed.[3] That they cannot, with due diligence, be found.[1] It follows that where the order, which was made in such a proceeding, did not state the fact that the shares had been lost or destroyed, but contained the statement that "they have been lost or destroyed as to the applicant Philip S. Biglin, and that they can not, after due diligence, be found in contemplation of law," — the court had no jurisdiction to order the issuing of a new certificate.[2]

Article XIV. Transfers of Shares Held in Trust.

[1] Biglin *v.* Friendship Association, 46 Hun (N. Y.), 223; *s. c.* 11 N. Y. St. Rep. 566.

[2] *Ibid.*

§ 2527. Issuing Stock to Third Persons "in Trust." — Corporate stock is frequently issued "in trust" to third persons, who are not regular subscribers therefor. The validity of these issues depends upon the construction of the governing statute and upon various considerations. It seems that a corporation cannot, by an arrangement of this kind, disable itself from issuing its remaining shares to *bona fide* takers at their par value,—that is, from filling up its capital stock in the regular way. Accordingly we find a case where it was held that a declaration alleging that the plaintiff, at the request of the defendants, a railroad corporation, had conveyed his stock therein to a third person, to be held in trust for certain purposes, and that the defendants, in consideration thereof, agreed with such trustee not to issue any additional stock without the consent of the contractors who were constructing their railroad, but that the defendants, without such consent, had issued other stock, whereby the value of that conveyed in trust by the plaintiff had been materially diminished, — discloses no ground of action.[1] The original issuing of corporate stock in trust is quite distinct from the act of all the stockholders of turning over their shares in trust to the managers of a so-called "trust" or combination, where the object is to unite all the corporations engaged in a given business under one management for the prevention of com-

[1] Poor *v.* European &c. R. Co., 59 Me. 270.

petition. The distinction consists in the fact that the shares, after they are issued, are the property, not of the corporation, but of the individual members; and the act is hence, in a strict sense, the act of the individual members, and not of the corporation. But, as it is the act of all, for purposes which concern the government of the corporation and the conduct of its business, a court looking loosely at the substance of things, has been able to say that such an act is the act of the corporation.[1]

§ 2528. Effect of Notice of the Trust on the Books of the Corporation: Duty of the Corporation to Protect the Rights of the Cestui que Trust. — Elsewhere it is shown that a corporation is a trustee for each of its shareholders in the sense that if it permits his shares to be transferred on its books in fraud of his rights, it is liable to him in damages for their conversion.[2] On principle, the corporation is equally bound to protect the rights of the beneficial owner of shares which stand on its books in the name of a trustee who holds them in trust for another. The beneficiary is the real owner, and his trustee is but the repository of his legal title. Although there has been some wavering of judicial opinion on this question,[3] yet most of the cases unite in holding that where the shares are so registered on the books of the company as to convey to the officers of the company notice that they are held in trust for a third person, the corporation is bound to see, before it permits a conveyance on its books by the trustee, that he has the consent of the *cestui que trust* where that is necessary, or that he is otherwise acting within the authority conferred upon him by the instrument creating the trust or by the decree of a court of competent jurisdiction; otherwise the corporation will be obliged to make good any loss

[1] A resolution to deliver the stock of a corporation to trustees of a certain association or combination, which is carried unanimously by the votes of all who are present, including every member of the trustees of the corporation and all the shareholders except two who own but a small part of the stock, and who are stated in fact to have consented to the delivery of the stock, — is sufficient to make the corporation a party to the combination. People *v.* North River Sugar Ref. Co. 54 Hun (N. Y.), 354; *s. c.* 5 L. R. A. 386; 7 N. Y. Supp. 406. This case was subsequently affirmed by the court of Appeals of New York; 121 N. Y. 582.

[2] *Ante*, § 2493, *et seq.*

[3] See Albert *v.* Savings Bank, 2 Md. 159; Albert *v.* Savings Bank, 1 Md. Ch. 407.

accruing to the trust estate from the unauthorized transfer. In short, if the corporation, having notice of the trust, permits the trustee to transfer without authority it is liable if he misappropriates the fund.[1] Therefore, one who holds corporation shares on the books of the corporation as "trustee of A. B." cannot insist upon their transfer by the corporation without exhibiting his authority in full.[2]

§ 2529. Different Classes of Fiduciaries, Administrators, Guardians and Assignees. — How far the company, or transfer agent, is chargeable with *notice* of the terms under which stock is held in a fiduciary capacity, depends largely upon the nature of the trust. In the case of administrators, guardians and assignees of the estates of insolvents, it would seem that the company, acting in good faith is discharged of any participation in the wrong, when it assures itself of the official character of the person seeking to make the transfer. For the law casts the legal title of the personal property of the estate upon such trustees. Their primary duty is administration, and involves the power to sell personalty, when necessary for the payment of debts or the proper management of the estate.[3] So, where the transfer is signed simply as administrator and is made to the "heirs and distributees" of the decedent, the company is not charged with notice of the existence and contents of a will, although in fact the transfer is made by an administrator *cum testamento annexo*, and passes the title to the stock to the legatees in accordance with the terms of the will; and consequently, is not liable for permitting a subsequent transfer in violation of the terms of the trust.[4]

[1] Stewart *v.* Firemen's Ins. Co., 53 Md. 564; Magwood *v.* Railroad Bank, 5 S. C. 379; Marbury *v.* Ehlen, 72 Md. 206; *s. c.* 20 Am. St. Rep. 467; Farmers &c. Bank *v.* Wayman, 5 Gill (Md.), 336, 356; Lowry *v.* Commercial &c. Bank, Taney (U. S.), 310; Bayard *v.* Farmers &c. Bank, 52 Pa. St. 232; Brewster *v.* Bartley, 37 Cal. 15; *s. c.* 99 Am. Dec. 237. See a note on this subject in 19 Am. & Eng. Corp. Cas. 412.

[2] Bayard *v.* Farmers &c. Bank, 52 Pa. St. 232.

[3] Bayard *v.* Farmers' &c. Bank, 52 Pa. St. 235; Field *v.* Schieffelin, 7 Johns. Ch. 150; *s. c.* 11 Am. Dec. 441; Wallace *v.* Holmes, 9 Blatchf. (U. S.) 65. Compare Atkinson *v.* Atkinson, 8 Allen (Mass.), 15.

[4] Smith *v.* Nashville &c. R. Co., 91 Tenn. 221; *s. c.* 18 S. W. Rep. 546.

§ 2530. [Indiana.] Administrator's Sale under Order of Court. — This doctrine is further illustrated as to administrators by the ruling of the Supreme Court of Indiana, where the common law right of the administrator to sell and dispose of personal property no longer exists. It is provided by statute that, in the absence of an order of court, the sale must be public, and that when the sale is private, under order of court, it must be made in substantial compliance with the order.[1] Under this state of the law it was held to be the duty of a corporation, before it transferred on its books shares of its stock which had been sold at private sale, to ascertain whether the terms of the order of court had been complied with. And where an order required the sale to be on good security, and the statute authorized a credit of only one year, and the administrator sold upon a credit of ten years, and accepted the individual note of the purchaser without security, the company was held liable for the loss occasioned by a registration of the transfer and the issuing of new certificates.[2]

§ 2531. Executors. — Generally speaking, an executor stands upon the same footing. His duty is to pay debts and legacies out of the personal estate, and even to use specific legacies to pay debts, if necessary. His letters testamentary show an apparent right to dispose of the stocks of the testator even though bequeathed specifically; and on principle, the company is bound to respect his title and transfer them according to his desire. The English courts have adopted this view in cases growing out of the duties of the Bank of England as transfer agent of shares in the public funds.[3] The principle has been recognized in those American cases in which the executor has acted solely in his capacity as executor, and the case is unembarrassed by any addi-

[1] 2 Rev. St. Ind. 1876, § 48, p. 509; *Id.* § 60, p. 512; Rev. St. 1881, §§ 2275., 2289. See also Weyer *v.* Bank, 57 Ind. 198; Williams *v.* Perrin, 73 Ind. 57.

[2] Citizens' Street Ry. Co. *v.* Robbins, 128 Ind. 449; *s. c.* 25 Am. St. Rep. 445; 12 L. R. A. 498; 9 Rail. & Corp. L. J. 155; 26 N. E. Rep. 116. Compare Marbury *v.* Ehlen, 72 Md. 206; *s. c.* 19 Atl. Rep. 648; Webb. *v.* Graniteville Mfg. Co., 11 South Car. 396; *s. c.* 32 Am. Rep. 479.

[3] Hartga *v.* Bank of England, 3 Ves. Jr. 55; Bank of England *v.* Parsons, 5 Ves. Jr. 665; Bank of England *v.* Lunn, 15 Ves. Jr. 569; Franklin *v.* Bank of England, 9 B. & C. 156; Fowler *v.* Churchill, 11 M. & W. 323; Franklin *v.* Bank of England, 1 Russ. Ch. 575. Compare Keane *v.* Robarts, 4 Mad. Ch. 177; McLeod *v.* Drummond, 17 Ves. Jr. 152. These cases all turn upon the legal title of the executor to the fund. The facts were not such as to charge him as trustee in addi ion to, or independently of, his office as executor.

tional trust relation growing out of the provisions of the will, and with a knowledge of which it is sought to charge the company.[1] Thus, in a case where the application for a transfer was made by a foreign executrix, and the company complied, although she had not taken out letters of administration from the local probate court, the court held that the fact that she had disposed of the stock in violation of the terms of the will, would not render the company liable in an action by an administrator *de bonis non*, appointed after her death; that it was not bound to see to the application of the proceeds of the stock nor to decide whether she had conformed to the terms of the will; that if she were guilty of a violation of official duty her sureties were responsible on the probate bond.[2] Where a company upon reorganization issued two *negotiable* certificates to an executor, redeemable in new stock, in place of stock belonging to the estate which he surrendered, it was held liable for a loss occasioned to the estate by his negotiation of the certificates, after his removal from office, and the issue of the new stock to the holders thereof.[3]

§ **2532. When the Executor is also Trustee.**—There are cases, however, which are difficult to reconcile with this view, in which it is said that the transfer being made by an executor, his character of executor is *notice* of itself that there is a *will* open to inspection on the public records, and that the company is charged with a notice of its contents and of the trusts which it creates as if it had actually read it.[4] Thus, where it appeared that the shares had stood in the name of the testator at the time of his death; that they were bequeathed in trust for complainant, who was to receive the dividends for life; that they continued in the testator's name for eight years after his death, without being required for the payment of debts; that one of the executors, while they were still in the testator's name, pledged them to secure his individual debt; that, upon the debt being paid, they were trans-

[1] Bayard *v.* Farmers' &c. Bank, 52 Pa. St. 232.

[2] Hutchins *v.* State Bank, 12 Met. (Mass.) 421.

[3] Mobile &c. R. Co. *v.* Humphries (Miss.), 7 So. Rep. 522.

[4] Lowry *v.* Commercial Bank, 1 Taney (U. S.), 310; Stewart *v.* Firemen's Ins. Co., 53 Md. 564; Caulkins *v.* Gaslight Co., 85 Tenn. 683; *s. c.* 4 Am. St. Rep. 786; 4 S. W. Rep. 287.

ferred to the name of a firm of which the executor was the sole member, and were retransferred by him to the name of himself and his co-executor as executors; that subsequently, signing as "acting executor," he transferred them in security of his personal debt, — the court held that the corporation, being aware of these facts, was charged with a knowledge that the executor was dealing with the stock as if it was his own property; also with notice of the fact that there was a will, and of its contents as if it had read it; and, therefore, of the trust under which the stock was held, and that it was liable for the loss sustained by complainant.[1]

§ **2533. Shares Held by "Guardian."** — If shares are transferred on the books of the corporation to A. B., with the addition of the word "guardian," this will charge the corporation with notice of the fact that the shares are held in trust; and if they are thereafter hypothecated without an order of court, and the corporation recognizes the transfer and completes it on its books, it will be liable for a conversion.[2] So where the certificate gives notice on its face that shares are the property of the minors, the transfer will be void both as to the company and the transferee.[3]

§ **2534. The Case of Trustees.** — Trustees, on the other hand, unlike administrators, guardians, assignees and executors, have no powers which are recognized as appurtenant to their office. They are vested only with the authority which is conferred upon them by the terms of their appointment. One who

[1] Lowry *v.* Commercial &c. Bank, Taney (U. S.), 310. Compare Albert *v.* Savings Bank, 2 Md. 159, reversing 1 Md. Ch. 407, a case growing out of the same estate and the transactions of the same executor. It was there held that the mere facts that the stock in question stood on the books in the names of the executors as such, and was subsequently transferred to them as "trustees" in connection with the privilege of a certain married woman to draw the dividends, were insufficient to charge the corporation with notice of the trust, and render it liable for a loss resulting from allowing the trustees to transfer the stock. See also Stewart *v.* Firemen's Ins. Co., 53 Md. 564.

[2] Webb *v.* Graniteville Man. Co., 11 South Car. 396; *s. c.* 32 Am. Rep. 479. In this case the shares had been indorsed in blank and placed by the guardian in the hands of his attorney for purposes connected with the administration, and were by the attorney hypothecated to secure his own debt.

[3] Atkinson *v.* Atkinson, 8 Allen (Mass.), 15.

deals with a trustee, as such, must be taken to have informed himself of the limits of his authority. Though he may have power to sell, it is not an incident of his office and must be expressly conferred. Where the certificate shows on its face that the stock is held in trust, one lending money on a pledge of it by the trustee, will be charged with notice of the fact that the latter is abusing his trust, when apparently the loan is for a private purpose, and an inquiry would reveal the fact.[1] And since the company is a custodian of the rights of the stockholders, such a notice to it of the fiduciary nature of the transferor's title will charge it with the obligation to ascertain the extent of his power to transfer it. If it permit a transfer without doing so, it will render itself liable to the *cestui que trust*, who is thereby injured.[2] To protect itself against such liability, it has a right to refuse a transfer of stock held in trust until the terms of the trust are submitted to its legal advisor.[3]

§ 2535. Lapse of Time will not Affect the Notice of the Trust. — When the company is once charged with a knowledge of the fact that the stock is held in trust and of the limited powers of the trustee, the mere lapse of time before the transfer in fraud of the *cestui que trust* will not affect its liability.[4]

§ 2536. Not Necessary that the Beneficiary should be Named on the Books. — An examination of the foregoing cases will show that it is not necessary that the name of the beneficiary should be disclosed on the books, to charge the corporation with knowledge of the trust: the addition of the word "executor," "guardian" or "trustee" is sufficient to *put it upon inquiry*, and that is enough. But it should be stated that there are at

[1] Duncan *v.* Jauden, 15 Wall. (U. S.) 165. See to the same effect Shaw *v.* Spencer, 100 Mass. 382; *s. c.* 97 Am. Dec. 107.

[2] Bayard *v.* Farmers' &c. Bank, 52 Pa. St. 232; Magwood *v.* Railroad Bank, 5 S. C. 379; Stewart *v.* Duffy, 53 Md. 564; Loring *v.* Salisbury Mills, 125 Mass. 138; Marbury *v.* Ehlen, 72 Md. 206; *s. c.* 20 Am. St. Rep. 467; 19 Atl. Rep. 648; Caulkins *v.* Gaslight Co., 85 Tenn. 683; *s. c.* 4 Am. St. Rep. 786; 4 S.W. Rep. 287.

[3] Bayard *v.* Farmers' &c. Bank, 52 Pa. St. 232.

[4] Marbury *v.* Ehlen, 72 Md. 206; *s. c.* 20 Am. St. Rep. 467; 19 Atl. Rep. 648.

least two early decisions to the contrary.[1] Thus, the transfer of stocks, standing in the name of certain persons "as executors," made by such persons to themselves "as trustees," though accompanied by authority to a third person to receive the dividends, was regarded as not sufficient to imply notice to the corporation of the interests of such third person in such stocks,[2] — a view which seems quite untenable. But it was conceded that if the trustee should offer to transfer, under circumstances calculated to excite suspicion that he was about to abuse his trust, the corporation would be bound to institute the necessary inquiries, and if it omitted so to do, and loss resulted, it would be obliged to make it good.[3] Recently, a different view has been taken of the effect of such entries upon the corporate records and on the face of the certificates. For instance, in one case it appeared that certain stock stood on the books of the corporation in the names of two persons, "executors of A.;" it was then transferred on the books to "B. guardian," and a certificate issued in B.'s name; B. was the guardian of the minor children of A.; B. indorsed the certificate, and entrusted it to C., his attorney; C., by petition in B.'s name, procured an order from a circuit judge for the sale of the stock and re-investment of the money; C. then hypothecated the stock to a bank for money for his own use; C. failed to redeem, and the stock was sold, the bank becoming the purchaser, and afterwards transferring it to its president, E., also president of the corporation, and to F. In an action by the wards, it was held that the books of the corporation, the certificates of stock, and order of the judge were sufficient to *put E. on inquiry*, and charge him with a knowledge of the trust and conversion; that his knowledge in the matter was the knowledge of the corporation of which he was president, and that the corporation, as well as B., the guardian, was liable.[4] Again, where a corporation has issued stock certificates showing on their face that they are to be taken by the holder as devisee under and subject to the provisions of a certain will, it is

[1] Albert *v.* Savings Bank of Baltimore, 1 Md. Ch. 407, and the case next cited.

[2] Albert *v.* Savings Bank of Baltimore, 2 Md. 159.

[3] Albert *v.* Savings Bank of Baltimore, 1 Md. Ch. 407.

[4] Webb *v.* Graniteville Man. Co., 11 S. C. 396; *s. c.* 32 Am. Rep. 479.

chargeable with notice of the contents of tha will and of the trusts imposed thereby, in all its subsequent dealings with such shares of stock.[1]

§ 2537. **When Shares are Registered as held "in Trust."**— It has been said that the fact that shares are entered in the books of a company and in a transfer as held "in trust" is sufficient of itself to put a purchaser on inquiry as to the right to sell them.[2] But the California court took a different view, and held that the mere addition of the word "trustee" after the name in the certificate, is not of itself, nothing more appearing, to be deemed constructive notice of the equities of a secret owner of the stock; that in the absence of apt words in the certificate limiting the authority of the trustee to sell or hypothecate the stock, the mere addition of the word "trustee" will raise no implication that he has not such authority.[3] This is a manifest departure from the general principle that one who deals with a party exercising a delegated authority is charged with a knowledge of the limitations upon his power. But in a Canadian case it is held that the words "in trust," following the names of the official designation of pledgees of corporate shares, running though a series of transfers of the legal title thereto, first by the original owner to a manager of a loan company, and subsequently by him and at his request to officers of various moneyed institutions, as security for loans to him personally, are to be construed as meaning that the transferees are trustees of the shares for the institutions for which they were respectively the officers or servants, and not for the original owner.[4]

§ 2538. **Other Circumstances under which Corporation Chargeable with Notice.**—The officers of a corporation are chargeable with notice of a contract to which the corporation is a party, by which the shares have been placed in his hands as trustee in pledge to secure a debt of the corporation.[5] But

[1] Caulkins *v.* Gaslight Co., 85 Tenn. 683; *s. c.* 4 Am. St. Rep. 786; 4 S. W. Rep. 287.

[2] Raphael *v.* McFarlane, 18 Can. S. C. 183.

[3] Brewster *v.* Sime, 42 Cal. 139.

[4] Duggan *v.* London &c. Loan Co., 18 Ont. App. Rep. 305; *s. c.* 34 Am. & Eng. Corp. Cas. 641.

[5] Brewster *v.* Hartley, 37 Cal. 15; *s. c.* 99 Am. Dec. 237.

knowledge of the fact that the transfer of stock to a national bank, made by an attorney of a trustee who had power to sell it, was in fact in fraud of the trustee and only a pledge for the attorney's individual indebtedness, is not imputed to a custodian of the stock who permitted the transfer, merely because the national bank had no power to purchase such stock.[1]

§ 2539. Illustration: Corporation Liable for Assisting in Unauthorized Sale of Shares Held in Trust.— In a case cited in the preceding section, shares in the stock of a corporation were held by a trustee under a will for the purposes of the trust therein created, of which will the corporation had notice. The trustee indorsed the shares in blank and transmitted them to a friend residing at the place of the principal office of the corporation, desiring him to sell the same. This intermediary employed a broker to effect a sale of the shares, and the broker having found purchasers for them, the intermediary applied to the secretary of the corporation for permission to surrender the old certificates to the corporation and for the corporation to issue new certificates of denominations suitable to the desires of the intending purchasers. After taking legal advice upon the question, which advice was to the effect that the corporation might so act, the secretary of the corporation filled up the blank power of attorney on the shares held by the trustee, so as to authorize the intermediary to transfer the shares to the intending purchasers by name according to the amount purchased by each. Retaining the old certificates, the company issued the new certificates to the purchasers. In a bill in equity, filed by the beneficiary in the trust under the will against the corporation and the intermediary through whom this conversion of the shares had been effected, it was held that the corporation was primarily liable to make good the amount so lost to the trust fund, and that the intermediary was secondarily liable, but that *purchasers* of the new certificates, receiving them *in good faith* and without knowledge of the real nature of the transaction, acquired a good title. And it was said that, even if such purchasers did not acquire a good title as against the real owner, they would have a remedy over against the corporation.[2]

§ 2540. Continued: Advice of Counsel does not Exonerate Corporation.— Where a corporation with knowledge of the terms of a trust created by a will, receives a surrender of shares of stock

[1] Peck *v.* Providence Gas. Co., 17 R. I. 275 *s. c.* Index JJ. 101; 15 L. R. A. 643; 23 Atl. Rep. 667.

[2] Caulkins *v.* Gaslight Co., 85 Tenn. 683; *s. c.* 4 Am. St. Rep. 786; 4 S. W. Rep. 287.

held by the trustee for the purposes of the trust, and issues new certificates to vendees, for the purpose of enabling the trustee to sell the shares, it is liable for their conversion to the beneficiary in the trust, although it may have acted in good faith and upon the advice of counsel.[1]

§ 2541. Liability for Issuing New Certificate where a Trustee Transfers in Breach of his Trust. — A corporation which has issued a certificate of stock to a person as trustee, and has notice of the name of the *cestui que trust*, but on the trustee's wrongful transfer of the certificate, issues a new one, without making inquiry, is liable to the rightful owner thereby injured, without proof of collusion between the trustee and itself.[2]

§ 2542. Trustee with Discretion to Sell. — Where the trustee is vested, under the terms of the instrument creating the trust, with a discretion to sell or otherwise dispose of the shares in question, it would seem that the company, in the absence of evidence to the contrary, has the right to assume that a proposed transfer is lawful and within the power conferred. It is not charged with a duty to investigate the grounds and purpose with which the discretion is exercised.[3]

§ 2543. Not Liable unless Registration of Transfer Contributes to Plaintiff's Loss. — In those jurisdictions where the rule prevails that the title of the stockholder passes upon the assignment of the certificate without registration on the corporate books, it is essential in establishing the liability of the company, that it should appear that its action in registering the unauthorized transfer by the trustee operated to aid the breach

[1] Caulkins *v.* Gaslight Co., 85 Tenn. 683: *s. c.* 4 Am. St. Rep. 786, 796. The court cite: Covington *v.* Anderson, 16 Lea (Tenn.), 314. In this last case the conversion was of a United States 5–20 bond, and the advice pleaded was of a treasury official.

[2] Loring *v.* Salisbury Mills, 125 Mass. 138. In such case, the fact that the *cestui que trust* has received *part satisfaction* from the trustee is no bar to the action against the corporation. *Ibid.*

[3] Peck *v.* Providence Gas Co., 17 R. I. 275 *s. c.* Index JJ. 101; 15 L. R. A. 643; 23 Atl. Rep. 967; affirming *s. c.* Index HH. 84; 10 Rail. & Corp. L. J. 55; 21 Atl. Rep. 543. To this general principle, see the full discussion, in Mason *v.* Bank of Commerce, 16 Mo. App. 275.

of trust and contributed directly to the loss of the stock by the *cestui que trust*. The mere fact that the company's officers were aware of the trust, or that the facts within their knowledge were sufficient to put them upon inquiry, as to the terms upon which it was held, and the right of the transferor to make the sale, is not sufficient. Said the Tennessee court, in a case where the company was charged with constructive notice that stock registered in the name of a husband, was in fact the property of the wife and the husband had no power to sell it, nevertheless registered a transfer made by the husband some months previously: "The negligence of the corporation in permitting the transfer must be the efficient and proximate cause of the loss sustained by the *cestui que trust*. If the purchaser's title was complete without the transfer, then it cannot be the efficient, proximate cause of the loss. Such a purchaser could compel a transfer to himself, and it would be the grossest injustice to hold the corporation responsible when its refusal would subject it to liability to the purchaser, and in no way improve the case of the *cestui que trust*." [1]

§ 2544. Bona Fide Purchasers of Such Shares Protected.— But the rule does not extend so far as to endanger the rights of *bona fide* purchasers of the shares: neither the shares nor their value can be recovered by or on behalf of the *cestui que trust* from such purchaser. While the successor in the trust, for instance, can maintain a bill in equity to recover them from the purchaser who took them from the original trustee with knowledge of the facts; yet he cannot maintain such a bill to recover shares which the former trustee assigned to one having no knowledge, from the shares or otherwise, of the trust.[2] Even where the *cestui que trust* is an *infant* at the time of the conversion, a subsequent *bona fide* purchaser is protected.[3] But it

[1] Smith *v.* Nashville &c. R. Co., 91 Tenn. 221 *s. c.* 18 S. W. Rep. 546.

[2] Atkinson *v.* Atkinson, 8 Allen (Mass.), 15. See also Citizens Street R. Co. *v.* Robbins, 128 Ind. 449; *s. c.* 25 Am. St. Rep. 445; 12 L. R. A. 498; 9 Rail. & Corp. L. J. 155; 26 N. E. Rep. 116.

[3] This is illustrated by a case where a testator bequeathed the use of certain shares of stock to his wife, remainder to his children. The administrator, by mistake, in the settle-

is necessary to keep carefully in mind the principle that the *bona fide* purchaser who is protected in such cases must be one who either has (1) no notice of the trust; or (2) no notice that the transfer is being made in violation of the trust; or (3) no notice or knowledge of facts which ought to put an honest and prudent man upon inquiry as to either of the two preceding facts. Within the *first* of these conditions, it is held that a *bona fide* purchaser of stock in a bank or other corporation standing in the name of trustees, *without notice of the trust*, will be protected, whether the trustees have the legal authority to make the transfer or not.[1] Within the *second*, it has been held that the mere addition of the word "*trustee*" to the name of the person who appears on the books of the corporation as the stockholder, with nothing to indicate the character of the trust, or the party beneficially interested, will not deprive him of the legal capacity to transfer the stock, though by so doing he may commit a breach of trust.[2] This is in conformity with the general principle which, in the absence of fraud, protects persons who purchase from trustees, which is, that where the *power* exists in the trustee to sell, or as it is sometimes called, to *vary the*

ment of the estate, distributed the stock to the widow absolutely, which distribution was accepted, and the administration account allowed, by the court of probate. The administrator transferred the stock to the widow on the books of the company, and six years afterward, a judgment creditor of the widow, in good faith, caused an execution against her to be levied on it as her property, and it was sold at sheriff's sale to A., who, a year afterward, sold it in good faith, for a valuable consideration, to B., a *bona fide* and innocent purchaser, to whom it was duly transferred on the books of the company. The petitioner, a daughter of the testator, was a minor when the decrees of the court of probate, accepting the distribution, and allowing the administration account, were passed, and on coming of age, appealed from them, and procured them to be reversed. On a bill in equity praying that the transfers might be set aside, and that B. might be ordered to transfer the stock to the administrator,— the court held that B. had a good legal and equitable title to the stock; and that if the petitioner had been wronged in the distribution of the estate, she had a remedy against the administrator on his probate bond, but was entitled to no relief as against B. Keeney *v.* Globe Mill Co., 39 Conn. 145.

[1] Albert *v.* Savings Bank, 1 Md. Ch. 407; Smith *v.* Nashville &c. R. Co. 91 Tenn. 221; *s. c.* 18 S. W. Rep. 546; Winter *v.* Montgomery Gaslight Co., 89 Ala. 544; *s. c.*. 7 South. Rep. 773; 8 Rail. & Corp. L. J. 244.

[2] Albert *v.* Savings Bank, *supra*.

securities,— the purchaser is not concerned with the disposition which he makes of the purchase money.[1]

§ 2545. Illustration: Bona Fide Purchase of Shares Affected with a Trust. — A recent case illustrating this principle exhibited the following facts: On March 30th, 1871, there stood on the books of the Montgomery Gaslight Company thirty shares of its capital stock in the name of J. S. Winter, trustee for Mary A. Winter. On that day "J. S. Winter, Trustee," assigned the thirty shares to J. Gindrat Winter, which transfer was duly registered on the books of the company. On August 21, 1871, certificates for the five shares in controversy, the same being a part of these thirty shares, were issued by the company to J. Gindrat Winter, who, on the 26th of the same month, delivered them to J. S. Winter, indorsing on each a power of attorney authorizing him to transfer, set over and assign on the books of the company, the shares to such person or persons, and for such consideration, as he might elect, with full power to appoint one or more persons with like power and authority to make the transfer of the shares. On August 26th, 1871, J. S. Winter, by an instrument in writing, assigned and transferred the certificates of these shares, together with all dividends, to D. S. Schanck to secure the payment of three notes, amounting in the aggregate to $500, which notes were given for his individual debt with irrevocable power of attorney to Schanck to surrender the certificate and to have a new certificate for the shares issued to him in his name. The shares were the statutory separate estate of Mrs. Mary E. Winter. It was held that, although J. Gindrat Winter had notice of the trust and of the fact that J. S. Winter was transferring the shares to secure his individual debt, yet as the transferee of J. Gindrat Winter had no such notice, he took the title free from the rights of Mrs. Winter. Said Clopton, J.: "The question presented by the record * * * is, when a certificate of stock is accompanied by a power of attorney, indorsed thereon by the person in whose name it is issued, authorizing the attorney to transfer it to any person for such consideration as he may elect, will the title of a purchaser for value without notice of any intervening equity, be protected? The general rule is that when the legal title and apparent unlimited power of disposition is vested in a person, the rights of a purchaser from him for a valuable consideration without notice of a secret trust upon which the property is held, are unaffected. The purchaser, in such a case, acquires an equity equal in dignity to the outstanding equity of which he has no notice. This principle is applicable to the sale and transfer of certifi-

[1] Mason v. Bank of Commerce, 16 Mo. App. 275.

cates of stock."[1] In such a case the defrauded *cestui que trust* would have an action against her unfaithful trustee, and possibly also against the corporation,[2] for the conversion of her shares.

§ 2546. Assignee in Insolvency not a Bona fide Purchaser. — But an assignee in insolvency, under the Massachusetts law, is not a *bona fide* purchaser, in such a sense that he can reclaim from the corporation shares which stand in the name of the insolvent without notice of a secret trust. On the contrary, the *cestui que trust* is entitled to have them transferred to him.[3]

§ 2547. Irregular Transfer by the Trustee to the Cestui que Trust. — The foregoing principle has been justly held not to apply where a transfer which, though irregular, but such as a court of equity would order on a proper application, is made by the trustee to the beneficiary in the trust.[4]

§ 2548. Several Trustees, All must Join in the Transfer. — Where the shares are held in trust by several trustees, in order to a valid transfer, all must join.[5]

§ 2549. Right of Cestui que Trust to Demand a Transfer.— Another case in which the corporation is bound to recognize the rights of the beneficial holder of stock, is where it has issued a certificate to one as trustee, and on his death the person claiming to be entitled to the shares demands a transfer. Of course, the company would not be justified in making

[1] Winter *v.* Montgomery Gaslight Co., 89 Ala. 544; *s. c.* 8 Rail. & Corp. L. J. 244; 7 South. Rep. 773.

[2] *Ante*, § 2528.

[3] Sibley *v.* Quinsigamond Bank, 133 Mass. 515. The court "do not think that the insolvent law was intended to pass rights of estoppel between the creditor and third persons." *Ibid.* 524.

[4] Butler *v.* Merchants' Ins. Co., 14 Ala. 777. Construction of a particular trust in respect of corporate shares, as between trustee and *cestui que trust:* Stevens *v.* Wilson, 18 N. J. Eq. 447.

[5] *Post*, § 2580. When, therefore, under the English Companies Clauses Act of 1845, § 18, the names of the executors of a deceased shareholder in a company are placed on the register of shareholders in respect of shares which belonged to their testator, they become joint shareholders in their individual capacity, although they may be described as executors in the register; and consequently the shares can only be transferred by means of a transfer executed by all of them. Barton *v.* London &c. R. Co., 24 Q. B. Div. 77.

such a transfer, and could not be compelled to make it until it had first been afforded an opportunity to examine the grounds upon which the claimant's rights were based. But where the company refused, in such a case, to examine the evidence offered and to permit a transfer, it was held proper, on a bill in equity against it to compel a transfer, where it appeared that it could easily have satisfied itself of the truth of the facts, to enter a decree against it for costs as well as to compel the transfer.[1]

§ 2550. **When Trustee not a Purchaser and not Liable for Unpaid Balances.**—Under a statute of Oregon, the purchaser of corporate shares becomes liable for unpaid balances; but there, if a shareholder who is indebted to the corporation transfers his shares to a trustee to sell to any one who will pay the debt, the trustee is not a purchaser and incurs no liability.[2]

§ 2551. **[Massachusetts.] Effect of a Sale by the Cestui que Trust.**—A sale, by the equitable owner, of corporate stock, held by trustees, under a trust agreement, transfers the seller's interest subject to the execution of the trust, and is not within the provisions of the statute of that State[3] which renders void every contract for the sale of stock, "unless the party contracting to sell or transfer the same is at any time of making the contract the owner or assignee thereof, or authorized by the owner or assignee or his agent to sell or transfer" the same.[4]

Article XV. Liable for Transferring on Forged Powers of Attorney.

SUBDIVISION I. Liability to the Original Shareholder.

[1] Iasigi *v.* Chicago &c. R. Co., 129 Mass. 46.

[2] Powell *v.* Willamette Valley R. Co., 15 Or. 393.

[3] Mass. Pub. Stat., chap. 78, § 6.

[4] Duchemin *v.* Kendall, 149 Mass. 171; *s. c.* 3 L. R. A. 784.

§ 2555. Scope of this Article. — If a corporation transfers on its books the shares of one of its shareholders, on a power of attorney or indorsement upon the certificate which has been *forged*, it incurs an alternative liability, — either (1) to the *original shareholder* for a conversion of his shares, or (2) to a *bona fide sub-transferee* of the shares, who has purchased them on the faith of the *new certificate* which the corporation has issued in consequence of the forgery. But it does not incur a liability to the first purchaser of the forged certificate, because it was his duty primarily to see that the transfer to him was genuine;[1] and, on the other hand, it may have an action against him, on the theory that he warrants the genuineness of the transfer under which he procures the transfer to be made on its books.[2] In treating of these questions in the present article it will be most convenient to consider: 1. The liability which the corporation incurs to the owner of the shares when it transfers them to another on a forged power of attorney or indorsement upon his share certificate. 2. The liability which it incurs to a *bona fide* transferee for value of the new share certificate which it issues to perfect such a transfer. 3. Certain matters not conveniently classified under the two preceding subdivisions.

§ 2556. Corporation Liable to Shareholder for Recognizing a Forged Indorsement. — A person cannot lose his prop-

[1] *Post*, § 2581.

[2] *Post*, § 2582.

erty by the crime of another. From the rule already stated that the corporation is, in a sense, the trustee of the title of the shareholder, and under the duty of seeing that transfers of the shares of its members shall not be made unless authorized by them,[1] it follows that it will be liable to one of its shareholders, as for a conversion of his shares, if it allows them to be transferred on a forged indorsement of the share certificate. In such a case the corporation acts at its peril, just as a bank acts at its peril in paying a check purporting to be that of a customer. It is bound to know the signature of its shareholder. If therefore the power of attorney on the old *certificate* has been *forged*, and the company issues a new certificate to the holder, it will be liable to the true owner for the conversion of his shares.[2]

§ 2557. Qualification that the Original Shareholder not Negligent. — The condition of the right of the shareholder to a remedy against the corporation is that he has *not been negligent* on his part in filling up the transfer on his share certificate in such a manner as to open the door to a fraudulent operation such as would deceive the officers of the corporation; and that they *have been negligent* on their part in not detecting the forgery. In this respect the law applicable to *negotiable instruments* applies to share certificates, although they are not negotiable. The owner of the shares must exercise *ordinary care*, adapted to the circumstances of the case, and so must the corporation.[3] So far as the negligence of the plaintiff is concerned, the governing principle, according to the American theory, is that stated by Lord Denman, that parties guilty of negligence which alters the rights of others are concluded by such negligence.[4]

[1] *Ante*, § 2486.

[2] Pratt *v.* Boston &c. R. Co., 126 Mass. 443; Telegraph Co. *v.* Davenport, 97 U. S. 369; Pratt *v.* Taunton Copper Co., 123 Mass. 110; *s. c.* 25 Am. Rep. 37; Pollock *v.* National Bank, 7 N. Y. 274; Sewall *v.* Boston Water Power Co., 4 Allen (Mass.), 277; *s. c.* 81 Am. Dec. 701; Re Bahia &c. R. Co., L. R. 3 Q. B. 584.

[3] Sewall *v.* Boston Water Power Co., 4 Allen (Mass.), 277; *s. c.* 81 Am. Dec. 701. That this is not the *English rule*, see *post*, § 2562.

[4] Coles *v.* Bank of England, 10 Ad. & El. 437, 451. Lord Denman cited Hume *v.* Bolland, Ry. & M. 371, and Davis *v.* Bank of England, 2 Bing. 393, 409, as recognizing this doctrine.

§ 2558. Such Negligence may Consist in Receiving Dividends on the Reduced Number of Shares. — Within the principle stated in the preceding section, the negligence of the shareholder, who has been defrauded by the forgery, may consist in receiving dividends from the corporation on the reduced number of his shares, although he receives such dividends without knowledge of the fraud which has been practiced upon him; since he is under the duty of inquiry, to the end that the corporation shall not be induced by his acceptance of the dividends to believe that the transfers are genuine. This is illustrated by an English case, where the executors of a shareholder brought an action on the case against the bank of England for refusing to transfer certain shares of their testatrix and for refusing to pay the dividends which had accumulated thereon. It appeared that nearly all the shares had been sold and transferred in the life time of the testatrix by her nephew C., who had brought another woman to personate her, and had forged her signature. It also appeared that after such sale the testatrix had repeatedly received the warrants for the dividends on the reduced number of shares, in person, and had signed the warrants and the bank books, being on those occasions accompanied by C., who mentioned the amount in her presence. Although this was evidently a case where an old and unsuspecting woman had been defrauded by the rascality of her nephew, who assisted her in the management of her affairs, the jury found, in response to questions put to them by Lord Denman, that she had the means of knowing of the transfer, although there was no evidence of her having had actual knowledge of it; that she had been guilty of gross negligence in not discovering it; and that the bank of England had not been guilty of any negligence. On this state of the case it was held, in substance, that the plaintiffs could not recover against the bank. "The defendants," said Lord Denman, "had been induced, by the conduct of the testatrix, to become responsible to others for that fund which they had possessed for her use, and to part with the money which they had received from the government to pay her dividends." [1]

[1] Coles *v.* Bank of England, 10 Ad. & El. 437, 452. In Bank of Ireland *v.* Trustees of Evans' Charities, 5 H. L. Cas. 389, this case received an interpretation, not only in the unanimous opinion of the judges of England, delivered to the House of Lords by Mr. Baron Parke, but also in the separate opinions of the Lords themselves, to the effect that what Lord Denman really held was that the negligent conduct of the plaintiff in receiving the dividends on the sum to which the stock was reduced by the forged transfers, was a *ratification* of those transfers, by which the stock was reduced to that amount. But this seems to be an unfaithful, or at least an inaccurate interpretation of that decision, and it seems to be better to

§ 2559. Doctrine that Shareholder's Right of Action not Concluded by Allowing the Escape of the Forger.— The English court of Common Pleas in 1824, in a very elaborate opinion written by Best, C. J., decided that a shareholder might recover from the Bank of England the dividends arising from his stock in the funds, though, at the time the dividends were payable, he knew that the stock had, some months previously, been placed, under a forged power of attorney, in the name of another person, and had omitted to notify the bank of the circumstance, and had not demanded payment of the dividends until after the escape of the offender.[1] The doctrine of this case seems to be entirely opposed to the doctrine of the case stated in the preceding paragraph; and Lord Denman in that case attempts to distinguish it. He states that it was reversed in error on the form of two of the counts;[2] "but the general doctrine does not appear to have been impeached: indeed, it is hardly more than the language of the act of parliament, though exceptions to it may arise out of particular circumstances. It might be added that the statutory provision in no wise differs from the common law liability of the banker to pay the money which he keeps for his customer, when some stranger, by a forgery, has abstracted the amount from his possession."[3] It may seriously be doubted whether the decision of Chief Justice Best, expresses the Amer-

regard it as Lord Brougham did, as "a somewhat doubtful case." In Swan *v.* North British Australasian Co., 2 Hurl. & Colt. 175, 181, decided in the court of Exchequer Chamber in 1863, Mr. Justice Blackburn, in giving his opinion, said that he did not consider Coles *v.* Bank of England to be binding in a court of error.

[1] Davis *v.* Bank of England, 2 Bing. 393.

[2] Bank of England *v.* Davis, 5 Barn. & Cres. 185. A reference to the reversing decision shows that it was reversed on the two counts on which judgment was given, namely, the second and fourth counts, on the ground that those counts represented that it was the duty of the bank to pay the dividends. The court said: "Now it could not be the duty of the bank to pay the dividends, until they had received them from the government. There is no allegation in the declaration that the bank ever had received the dividends from the government, nor is there any fact found by the jury to cure the want of that allegation. Without saying what would have been our decision if that fact had been alleged or found by the jury, we are of opinion that the second and fourth counts of the declaration are not sufficient, and that the judgment must on that ground be reversed."

[3] Such were the comments of Lord Denman on the preceding case, in Coles *v.* Bank of England, 10 Ad. & El. at p. 449.

ican,[1] though it seems to express the present English law. He conceded that if the bank had admitted to registration the forged transfers, it would have thereby estopped itself from repudiating the rights of the transferees as shareholders after discovering the forgery; but, in order to take the case out of the principle already laid down by Lord Denman, and which is now no doubt the American law, he dwelt on the fact that the bank of England failed to prove that, in consequence of the forgery, they had paid dividends to other persons. "It is not enough," said he, "for the defendants to say that they might have paid these dividends to other persons: to defend an action on the principle laid down by Lord Mansfield,[2] they must prove that they have paid them to persons to whom they could have refused to pay them had they been informed of the forgeries. No evidence of any such payment appears on the case."[3]

§ 2560. Continued: Reasons for Concluding that to Allow the Forger to Escape does not Bar Shareholder's Right of Action against Corporation. — In the case already referred to it was urged, in behalf of the Bank of England, that on principles of public policy, the plaintiff ought not to be permitted to prevail in the action, for the reason that, instead of prosecuting the felon, he had been guilty of *misprision of felony*, by allowing him to escape. Mr. Chief Justice Best disposed of this argument in the following language: "Public policy is a doctrine on which judges should proceed with caution; otherwise the rights of the subjects of this country would depend on their discretion. There are many things which most of us think against good policy, for which actions are brought; for instance wagers. We ought not to trust ourselves with so dangerous a power as that of acting judicially on disputable policy. Can we say that indisputable policy requires that a man should lose his all for misprision of felony? Policy prevents the assertion of a civil right only in cases where the action is brought for doing something directly injurious to the public, or declared to be so by positive law. Thus, if the law has forbidden the

[1] *Ante*, § 2557.

[2] Best, C. J., here referred to the language of Lord Mansfield in Bird *v.* Randall, 3 Burr. 1353, — that "whatever will in equity and conscience, according to the circumstances of the case, bar the plaintiff's recovery, may * * * * be given in evidence by the defendant, because the plaintiff must recover upon the justice and conscience of his own case, and on that only."

[3] Davis *v.* Bank of England, 2 Bing. at p. 409.

doing of an act, it has recognized the impolicy of doing it; or, if it has commanded an act to be done, it has recognized the impolicy of not doing it, and the courts would not allow an action to be maintained for doing the act prohibited, or abstaining from doing the act commanded. Therefore, if the plaintiff's action had been founded on the concealment of the forgeries, it could not have been supported. But the action is founded on the refusal of the bank to pay on demand the dividends *of the plaintiff*, due on stocks belonging to him. The misprision of felony of which he has been guilty forms no part of his case. If misprision of felony is to be opposed to the action, it must be on the ground that the plaintiff, having had a good cause of action on account of the bank's refusing to do their public duty by paying him his dividends, has forfeited his right to maintain such action by being guilty of misprision of felony. We know nothing of forfeitures on notions of public policy. For forfeitures we must have positive law. Misprision of felony is but a misdemeanor, and punished, not by any forfeiture, but by fine and imprisonment, at the discretion of the court before which the offender is convicted. The defendants' counsel have attempted to apply to this case the rule that civil actions are merged in a felony. If the plaintiff were seeking to recover what had been obtained by reason of these forgeries, either from the forger or any person who had received it from him, defendants might protect themselves under this rule. But it has never been held that the owner can not, before prosecution of the felon, proceed for redress against the persons through whose negligence the thief committed the felony. If goods are stolen from a carrier or innkeeper, the owner may bring his action against them without instituting any prosecution against the felon. The bank stands in the situation of the carrier and innkeeper. It has never been decided that a concealment of the felony from the carrier or innkeeper by the owner of the goods was an answer to such an action. Concealment can be no answer, except the jury were to infer from it that the owner was privy to the robbery or the defendant could show that such concealment had prevented him from recovering the goods. This case was put to us in argument: A., knowing that B. has forged A.'s name to a draft on his banker, sees B. come out of the banker's shop with the money obtained by the forgery, and neither arrests B. nor gives any information to the banker. Could A. recover this money again from the banker? A jury in such a case must find that A. was privy to the forgery at the time it was committed, and would, I think, infer that A. assented to it, and such finding would prevent his recovering in an action against the banker. But in the present case the jury have expressly negatived all knowledge on the part of the plaintiff until three months after the forger-

ies. They have also negatived assent, saying they have no evidence of assent except the concealment of what came to the plaintiff's knowledge five months after the forgeries, from which they have not inferred assent, nor can we. A verdict must therefore be entered for the plaintiff on the second and fourth counts, for the amount of the dividends demanded by him from the bank, and which they, contrary to their duty, refuse to pay him."[1]

§ 2561. Theory of Liability where Certificates are Fraudulently Transferred by Holder's Agent. — Some of the American cases go to the extent of holding that the company is not liable to the holder of the shares, who, by his own voluntary act, puts it into the power of another to make a fraudulent transfer of them on the books of the company. Here, the governing principle is like that which obtains where shares have been indorsed in blank and pledged as collateral, and fraudulently transferred by the pledgee to an innocent taker: he gets a good title, on the ground that where one of two innocent persons must suffer by the fraud of a third, the loss should rather fall on him who enabled the third person to commit the fraud.[2] No reason is perceived why the same principle should not protect the corporation, and it has been so held. Thus, where the owner of shares intrusted the certificates, with blank powers of attorney, *to his own agent* for safe-keeping, and the agent fraudulently transferred them to a third party, who, in turn, without knowledge of the fraud, had them transferred to himself, it was held that the owner could not recover from the corporation for the loss.[3]

§ 2562. Not Negligence for the Shareholder to Afford an Opportunity for a Forgery. — The present *law of England* is that the mere fact that the shareholder reposes confidence in another, in such a manner as to make it *possible* for him to commit a fraud upon third persons and upon the corporation, by

[1] Davis *v.* Bank of England, 2 Bing. 393, 410–412. This judgment was, as already stated, reversed by the House of Lords on technical grounds connected with the form of these counts, but without impugning the doctrine thus laid down. See note to preceding section.

[2] *Post*, § 2595.

[3] Pennsylvania R. Co.'s Appeal, 86 Pa. St. 80.

means of executing a *forged transfer* of the shares, does not make the loss thereby entailed the natural or probable result of the confidence thus reposed; because the forgery, not being the natural and probable consequence of the negligence, but an unusual and extraordinary act, is not the *proximate*, but is the *remote consequence* of such *negligence*.[1] In other words, the English courts do not presume that a reputable man in whom confidence is reposed is to be regarded as likely to commit a forgery; and perhaps the reason why the American courts go farther in holding the shareholder estopped, so to speak, by his negligence, is that forgery is more frequent in America than in England. We add that the English doctrine seems to have been substantially adopted in a recent decision of the Supreme Judicial Court of Massachusetts, to which more extended reference will hereafter be made.[2]

§ 2563. An Illustration of the English Doctrine. — An *incorporated shareholder* does not lose its rights by a fraudulent transfer through the unauthorized use of its seal. The English doctrine is illustrated by a decision in the House of Lords, in which the lords were not only unanimous, but had the advantage of the unanimous opinion of the judges of England, delivered at their bar, in support of the doctrine which they announced, — a circumstance which makes the case authoritative in the highest degree, so far as concerns the law of that country. The trustees of a charity in Dublin, incorporated by an act of parliament and having a common seal, possessed certain stock in the public funds, which stock was, in Ireland, registered in the Bank of Ireland. G., the secretary of the incorporated trustees, was allowed to have their corporate seal in his possession. Five several powers of attorney, prepared in different years, sealed with the seal of the incorporated trustees, the due affixing of which seal was attested by witnesses, who (though without any fraudulent intention) attested what was not true, since the seal was affixed by the unauthorized act of the secretary alone, — were presented to the Bank of Ireland, and the stock was transferred on the faith of them. It was afterwards discovered that

[1] Bank of Ireland *v.* Evans' Charities, 5 H. L. Cas. 389; Staple of England *v.* Bank of England, 21 Q. B. Div. 160, 176; Swan *v.* North British Australasian Co., 2 Hurl. & Colt. 175, 189; see also Vagliano *v.* Bank of England, 22 Q. B. Div. 103, 117; *s. c.* affirmed, 23 Q. B. Div. 243, 255; *s. c.* reversed in H. L. (1891), 1 App. Cas. 107.

[2] Hill *v.* Jewett Pub. Co., 154 Mass. 172; *s. c.* 13 L. R. A. 193.

these letters of attorney were forged by G., and he was indicted for the forgery and convicted. By a power of attorney, duly executed, the trustees of the charity then authorized C. to transfer the stock, but the bank refused to make the transfer. An action was brought by the trustees against the bank for damages, for this refusal. The judge who tried the case instructed the jury that if, under these circumstances, — that is, by allowing their secretary to have the custody of their seal, — the trustees had so negligently conducted themselves as to contribute to the loss, — the verdict must be given for the bank. It was held that this direction was erroneous. Mr. Baron Parke, in giving the opinion of the judges at the bar of the House of Lords, said on this question: "If there was *negligence* in the custody of the seal, it was very remotely connected with the act of transfer. The transfer was not the necessary, or ordinary, or likely result of that negligence. It never would have been but for the occurrence of a very extraordinary event, that persons should be found either so dishonest or so careless as to testify on the face of the instrument that they had seen the seal duly affixed. It is quite impossible that the bankers could have maintained an action for the negligence of the trustees, and recover the damages they had sustained by reason of their having made the transfer. If such negligence could disentitle the plaintiffs, to what extent is it to go? If a man should lose his cheque book, or neglect to lock the desk in which it is kept, and a servant or stranger should take it up, it is impossible, in our opinion, to contend that a banker paying his forged cheque would be entitled to charge his customer with that payment. Would it be contended that if he kept his goods so negligently that a servant took and sold them, he must be considered as having concurred in the sale, and so be disentitled to sue for their conversion on a demand and a refusal? It is clear, we think, that the negligence in the present case, if there be any, is much too remote to affect the transfer itself, and to cause the trustees to be parties to misleading the bank in making the transfer on the forged power of attorney."[1] Lord Cranworth, L. C., expressed a concurring opinion in this language: "The direction was that if the transfer was caused by such negligence on the part of the trustees as that of which evidence has been given, then that the bank was absolved. I apprehend that there is no such principle of law. I think it has been fairly put, that there must be either something that amounts to an *estoppel*, or something that amounts to a *ratification*, in order to make the negligence a good answer."[2]

[1] Bank of Ireland *v.* Evans' Trustees, 5 H. L. Cas. 410, 411.

[2] *Ibid.*, 413. The lords distinguished Young *v.* Grote, 4 Bing. 253, in which it was held to have been such negligence on the part of the drawer

§ 2564. Another Illustration of the English Doctrine.— In a case finally decided in the English Court of Exchequer Chamber in 1863, with the concurrence of six judges, against one dissenting judge,[1] the plaintiff was the registered owner of 1,000 shares in a joint-stock company, in which the shares could only be transferred by deed executed by both transferor and transferee. He employed a broker to sell for him some shares in another company, which were also transferable by deed only. The broker represented to him that it was necessary for him to execute ten blank forms of transfer. The plaintiff accordingly signed, sealed and delivered to the broker ten forms of transfer in blank, to be filled up by him for the transfer of the shares in the other company. The broker used only eight of the blank forms for that purpose; and, having stolen the share certificates from a box deposited at a bank for safe custody, he feloniously filled up the two remaining forms, as transfers, respectively, of 500 of the plaintiff's 1,000 shares in the first named company. He then forged the attestations, and delivered the transfers, together with the certificates, to *bona fide purchasers for value*, who presented them to the company to have the transfers executed to them. The company thereupon removed the plaintiff's name from the register of shareholders, and placed in its stead the names of these innocent purchasers. It was held in the Exchequer Chamber, affirming the judgment of the Court of Exchequer, that there was no such *negligence* on the part of the plaintiff as *estopped* him from insisting that the property in the shares did not pass under the transfers.[2]

of a check to draw it in such a manner as to admit of an easy interpolation, as would prevent him, in case of a fraudulent interpolation misleading the banker, to maintain an action against the banker for paying the check as thus fraudulently altered. On the authority of Bank of Ireland v. Evans' Charities, 5 H. L. Cas. 389, a more recent case was decided in the English court of appeal, where the plaintiff, a corporate body, left their seal in the custody of their clerk, who, without authority, affixed it to powers of attorney, under which certain stock in the public funds, the property of the plaintiffs was sold. The clerk appropriated the proceeds. In an action against the Bank of England, in which it was claimed that the plaintiffs were entitled to the stock, on the ground that it had been transferred by the bank without their authority, it was held that, assuming that the plaintiffs had been negligent in so disposing of their seal, their negligence was not the proximate cause of the loss, and did not prevent them from maintaining the action. Staple of England v. Bank of England, 21 Q. B. Div. 160.

[1] The concurring judges were Cockburn, C. J., and Crompton, Willes, Byles, Blackburn and Mellor, JJ.; Keating, J., dissented.

[2] Swan v. North British Australasian Co., 2 Hurl. & Colt. 175. Keating, J., in his dissenting opinion relied

§ 2565. English Rule where Blank Transfers are Lodged with a Broker who Fraudulently Fills them up. — It has been held, in an equity case in England, that where transfers have been executed in blank as to particular shares and lodged with a broker, and the broker has fraudulently filled up the blanks so as to transfer shares not intended by the transferor, and the shares have been sold, — the *transfer is void*, and the original owner is entitled to have the certificates delivered up, and their registration in the name of the purchaser restrained.[1]

§ 2566. Alteration of an Assignment of a Part of the Shares Named in the Certificate, so as to Make it an Assignment of All. — It has been held, in a very interesting American case, that a shareholder may execute, on the back of his share certificate, a good *assignment in blank of a part of the shares named therein*, so that it will be the duty of the corporation, on the presentation of the certificate to it, to execute to the person, whose name is inserted in the blank, a *new certificate* for the number of shares thus assigned to him, and to take up and hold the old certificate, and to issue to the assignor a new certificate for the unassigned shares on his demand therefor. It followed that, where the shareholder held a certificate for 200 shares, and executed, on the back of the certificate, in blank, an assignment of fifty of those shares, but in such a manner that an alteration of the assignment could not be made so as to show the assignment of a greater number without mutilating the instrument, so that the alteration could be detected by the exercise of ordinary care, and in this manner delivered the certificate to his assignee, after which the certificate was altered, not fraudulently, but through an act of *gross negligence* on the part of a clerk, so as to make it appear that the whole number of shares had been assigned, and the alteration was made in such a way as to exhibit the certificate to the officers of the bank in a mutilated form, and the bank issued a new certificate for the whole 200 shares to the person filling up the blank and demanding them,— *the bank was liable to the original shareholder* for the conversion of 150 of his shares. As the officers of corporations will be curious to know the manner in which the assignment was originally filled out, and also the manner in which it was subsequently altered, both are printed below. The assignment on

upon Ex parte Swan, 7 C. B. (N. S.) 429, and some of the other judges distinguished that case from the case before them.

[1] Tayler *v.* Great Indian Peninsular R. Co., 4 De Gex & J. 559.

the back of the certificate, before alteration and as the certificate was delivered, was as follows:

In consideration of Dollars, to me paid, I do hereby sell and assign to.

of —— *Fifty* of the within named —— Shares of the Corporate Stock of the BOSTON WATER POWER COMPANY.

Witness my hand and seal, this *15* day of *March* A. D. eighteen hundred and *sixty*.

S. E. SEWALL.

Signed, sealed and delivered, in presence of T. R. SEWALL.

The assignment as altered, was as follows:

In consideration of *ten* Dollars, to me paid, I do hereby sell and assign to ~~*J. B. Neale, Trustee,*~~

J. E. Bullard, Trt. 50.

Allen, Neale & Co. 150.

~~of~~ *all* —— ~~*Fifty*~~ of the within named *Two hundred* Shares of the Corporate Stock of the BOSTON WATER POWER COMPANY.

Witness my hand and seal this *15* day of *March* A. D. eighteen hundred and *sixty*.

S. E. SEWALL.

Signed, sealed and delivered, in presence of T. R. SEWALL.

What made the case worse for the corporation was that its own clerk, who had charge of making transfers of its shares, assisted, although innocently, in this alteration. "Without any fraudulent intent, but with gross carelessness, he undertook to alter the assignment still more. Probably he erased the word 'fifty,' though this may have been done by Bullard (the clerk of the brokers, to whom the fifty shares had been assigned). He wrote upon the ink line 'two hundred' in the space before 'shares;' and inserted in another space the word 'all,' and erased a superfluous 'of;' and thus, by his own act, made it a proper assignment of the plaintiff's shares, so far as its language was concerned." After these various alterations, the assignment stood as above represented. The brokers, to whom the one hundred and fifty shares were issued in consequence of this negligent alteration, became insolvent, and hence the plaintiff sought recourse against the bank in

an action for the *conversion* of these hundred and fifty shares, and was successful.[1]

§ **2567. Original Shareholder has a Remedy in Equity against Corporation.**— If a power of attorney to make a transfer of such shares is forged, and a transfer is accordingly made by the corporation, the rightful stockholder may maintain a bill in equity to compel the corporation to issue to him a new certificate for his shares and to pay dividends thereon; in other words he may maintain a bill to compel the corporation specifically to perform what it has undertaken in his favor.[2] The court, in what appears to be the oldest case on this question, said: "As to the company, they were but instruments and conduit-pipes; or, like the lord of a manor in the case of the surrender of a copyhold, where, if there should be a forged letter of attorney, empowering one of the copyholders to surrender to the use of one J. S., and thereupon the attorney in the name of the copyholder should surrender to the use of J. S., who should be accordingly admitted by the lord, yet this admittance would be void; and so is the transfer of this stock to the defendant Keate; and it would be of public use, that those who accept of a transfer of stock under a letter of attorney, should be obliged to take strict care of the validity and reality of such letter of attorney, for no other person can be so properly concerned to do it."[3] The ordinary *form of equitable relief* is a decree compelling the corporation to re-instate him on its books, and to issue a proper certificate of stock to him and to pay him the dividends declared on the stock after its unauthorized transfer, or an *alternative decree* for the *value* of the stock and dividends.[4] It has been held that if an indorsement upon a certificate of shares is

[1] Sewall *v.* Boston Water Power Co., 4 Allen (Mass.), 277; *s. c.* 81 Am. Dec. 701.

[2] Ashby *v.* Blackwell, 2 Eden, 299; *s. c.* Ambl. 503; Sloman *v.* Bank of England, 14 Sim. 475; Midland R. Co. *v.* Taylor, 8 H. L. Cas. 751; Pollock *v.* National Bank, 7 N. Y. 274; Sewall *v.* Boston Water Power Co., 4 Allen (Mass.), 277; *s. c.* 81 Am. Dec. 701; Pratt *v.* Taunton Copper Co., 123 Mass. 110; *s. c.* 25 Am. Rep. 37; Hildyard *v.* South Sea Co., 2 P. Wms. 76; Telegraph Co. *v.* Davenport, 97 U. S. 369; *ante*, § 2425.

[3] Hildyard *v.* South Sea Co., 2 P. Wms. 77, 78.

[4] Telegraph Co. *v.* Davenport, 97 U. S. 369. In the case above cited from Peere Williams a form of the decree will be found.

forged, and the certificate is transferred for value to an *innocent purchaser*, and he thereafter presents the same to the corporation, and the latter, without negligence, issues to him a new certificate, and the holder of the new certificate sells the same, but the corporation refuses to issue another new certificate to the second vendee, by reason of having discovered the fact of the forgery, — the *original holder* of the certificate may maintain a suit in equity against the first transferee and the corporation to compel the first transferee to deliver up the certificate issued to him, and to compel the corporation to issue a new one to the complainant. As between the first and second transferees, the latter must look to the former, his transferor, for indemnity. As between the first transferee and the corporation, the equities are in favor of the corporation, both being equally free from negligence; for the first transferee having first parted with his money on the faith of the forgery of the indorsement, can not be allowed to shift the consequences of his misfortune upon the corporation, equally innocent. Even if the corporation was negligent, its *negligence* was not the *proximate cause* of the loss of the first transferee, because such loss had previously accrued. If the second purchaser, being a *bona fide* purchaser for value, had been registered as the owner of the stock by the corporation, a different question would be presented as between him and the company.[1]

§ **2568. Original Shareholder no Remedy as against Subsequent Purchaser.** — But suppose that, in such a case, the new certificate, which the corporation issued to take up the certificate having the forged power of attorney, has passed into the hands of a *bona fide* purchaser for value. In such a case other equities may arise between the original shareholder and the subsequent purchaser; at least, the rights of such purchaser cannot be concluded in a suit in equity between the original shareholder and the corporation. The original shareholder cannot have a decree against him, because he has rights against the corporation which depend upon the effect of the certificate which he has

[1] Brown *v.* Howard Fire Ins. Co., 42 Md. 384; *s. c.* 20 Am. Rep. 90. Compare Swan *v.* North British Australasian Co., 7 Hurl. & N. 603; Lowry *v.* Com. &c. Bank, Taney (U. S.), 310.

received from it; though if he knew or was bound to know that the power of attorney under which the transfer was made was forged, a different case would be presented.[1]

§ 2569. Notice to Shareholder of Application to Register not an Estoppel. — It is held in the English Queen's Bench Division that where, on application to a company to register a transfer of stock, the company sent a letter giving notice of it to the holder of stock on the register, and stating that, unless they heard from her to the contrary, the stock would be transferred in their books, and she did not answer the letter, and the company subsequently registered the transfer, — she was not estopped from alleging that her signature to the transfer was a *forgery*, and demanding to have her name replaced on the register as holder of the stock,[2] — a decision which seems contrary to reason and justice.

SUBDIVISION II. Liability to Bona Fide Sub-purchaser.

§ 2572. Foundation of the Rule which Holds the Corporation thus Liable. — In several cases, the English judges have traced the foundation of the rule which holds the corporation liable, to the rule thus declared in the Court of Queen's Bench,— "that, where one, by his words or conduct, willfully causes another to believe in the existence of a certain state of things, and induces him to act on that belief, or to alter his own previous position, the former is concluded from averring against the latter a different state of things as existing at the same time." [3] The principle is more broadly stated by Lord Denman, C. J., where

[1] Pratt *v.* Taunton Copper Co., 123 Mass. 110; *s. c.* 25 Am. Rep. 37.

[2] Barton *v.* London &c. R. Co., 24 Q. B. Div. 77.

[3] Pickard *v.* Sears, 6 Ad. & El. 474; *s. c.* 2 Nev. & P. 491. That rule is said to have been founded on previous authorities, such as Graves *v.* Key, 2 Barn. & Ad. 318, and Heane *v.* Rogers, 9 Barn. & Cres. 586.

he says that a party who negligently or culpably stands by and allows another to contract on the faith of a fact which he can contradict, can not afterwards dispute that fact in an action against the person whom he has assisted in deceiving.[1] Re-affirming this doctrine, that eminent lawyer, Baron Parke, said: "By the term 'willfully,' however, in that rule, we must understand, if not that the party represents that to be true which he knows to be untrue, at least, that he means his representation to be acted upon, and that it is acted upon accordingly; and if, whatever a man's real intention may be, he so conducts himself that a reasonable man would take the representation to be true, and believe that it was meant that he should act upon it, and did act upon it as true, the party making the representation would be equally precluded from contesting its truth; and conduct, by negligence or omission, where there is a duty cast upon a person, by usage of trade or otherwise, to disclose the truth, may often have the same effect."[2] It is thus perceived that this principle is the ordinary doctrine of *estoppel in pais.* Now let us consider its application to the case of a *corporation which issues a new certificate to the transferee of shares whose transfer has been forged.* In order to understand the position in which the corporation thus puts itself, it is necessary to recur to the nature of a share certificate;[3] and this has been thus explained, in a leading case on the question under consideration, by Lord Cockburn, C. J.: "The company are bound to keep a register of shareholders, and have the power to issue certificates certifying that each individual shareholder named therein is a registered shareholder of the particular shares specified. This power of granting certificates is to give the shareholders the opportunity of more easily dealing with their shares in the market, and to afford facilities to them of selling their shares by at once showing a marketable title, and the effect of this facility is to make the shares of greater value. The power of giving certificates is, therefore, for the benefit of the company in general; and it is a *declaration by the company to all the world* that the person in whose name the certificate is made out, and to whom it is given, is a share-

[1] Gregg *v.* Wells, 10 Ad. & El. 97.

[2] Freeman *v.* Cooke, 2 Exch. 654, 663.

[3] This has been explained elsewhere; *ante,* § 2349, *et seq.*; *post,* § 2587, *et seq.*

holder in the company, and it is given by the company with the intention that it shall be so used by the person to whom it is given, and acted upon in the sale and transfer of shares."[1] The application of the principle immediately suggests itself to the mind; the corporation is bound by the representation which it thus makes to the public, either to treat innocent persons deceived by the representations as shareholders, or to indemnify them in respect of what they have lost in consequence of the representation. Such was the application of the principle made by the same eminent judge in the continuation of his opinion: "It is stated in this case that the claimants acted *bona fide*, and did all that is required of purchasers of shares; they paid the value of the shares in money on having a transfer of the shares executed to them, and on the production of the certificates which were handed to them. It turned out that the transferors had in fact no shares, and that the company ought not to have registered them as shareholders or given them certificates, the transfer to them being a forgery. That brings the case within the principle of the decision in Pickard *v.* Sears,[2] as explained by the case of Freeman *v.* Cooke,[3] that if you make a representation with the intention that it shall be acted upon by another, and he does so, you are estopped from denying the truth of what you represent to be the fact."[4] Lord Blackburn, another very eminent judge, expressed the same opinion in a little different language: "The statute," said he, "further provides that the company may give certificates specifying the shares held by any member; and the object of this provision is expressly stated to be that this certificate should be *prima facie* evidence of the title of the person named to the shares specified; and the company, therefore, by granting the certificate, do make a statement that they have transferred the shares specified to the person to whom it is given, and that he is the holder of the shares. If they have been deceived and the statement is not perfectly true, they may not be guilty of negligence, but the company, and no one else, have the power to inquire into the

[1] Re Bahia &c. R. Co., L. R. 3 Q. B. 584, 594, 595.

[2] 6 Ad. & El. 469.

[3] 2 Exch. 654; *s. c.* 18 L. J. Exch. 114.

[4] Re Bahia &c. R. Co., L. R. 3 Q. B. at p. 595.

matter; and it was the intention of the legislature that these certificates should be documents on which buyers might safely act. * * * And the claimants, having *bona fide* acted upon that statement and suffered damages, can they recover from the company? I think they can, on the principle enunciated in Freeman *v.* Cooke." [1]

§ 2573. Further of the Doctrine that the Corporation, by Admitting the Forged Transfer to Registration, Estops Itself in Favor of an Innocent Transferee.— The important judgment of Mr. Chief Justice Best, already referred to,[2] includes dicta to the effect that if the corporation admits the forged transfer to registration, it thereby estops itself as against an innocent transferee, from disputing his rights as a shareholder. "We are not called on," said he, "to decide whether those who purchase the stock transferred to them under the forged powers might require the bank to confirm that purchase to them, and to pay them the

[1] Re Bahia &c. R. Co., L. R. 3 Q. B., at p. 596, 597; Mellor and Lush, JJ., expressed similar opinions. As late as 1890 the soundness of this decision was thus doubted in an editorial in the *Law Times*, one of the leading legal journals in England: "But is the Bahia case perfectly good law? We are rather inclined to doubt it. The ground of that decision was, that the company, by giving a certificate, had enabled the transferees, under the forged transfer, to hold themselves out as real owners. Now by Sect. 12 of the Companies Clauses Act, 1845, which applies to all railway companies incorporated in and after 1845, and is to a great extent similar to Sect. 31 of the Companies Act, 1862, on which the Bahia case was decided, it is enacted that 'the certificate shall be admitted in all courts as *prima facie* evidence of the title of the shareholder.' In the Bahia case the court held that the doctrine of Freeman *v.* Cooke (2 Ex. 654) applied, and that the company was 'estopped.' But in Swan *v.* North British Australasian Company (2 H. & C. 188), Cockburn, C. J., observed: 'To bring a case within the principle established by the decision in Freeman *v.* Cooke it is essentially necessary that the representation or conduct complained of, whether active or passive in its character, should have been intended to bring about the result whereby loss has been occasioned to the other party, or his position has been altered;' and the opinion of Blackburn, J., is to the same effect. Curiously enough, both these judges were parties to the judgment in the Bahia case, and saw no difficulty in applying the principle of Freeman *v.* Cooke to it. For ourselves, we submit with diffidence that there is considerable difficulty in so applying it; but, as we have already said, the Bahia case has never been judicially called in question; and it appears to have been approved of in Hart *v.* Frontino &c. Company (22 L. T. (N. S.) 30)."

[2] *Ante*, §§ 2557, 2560.

dividends on such stocks, or whether their neglect to inquire into the authenticity of the power of attorney might not throw the loss upon them that has been occasioned by the forgeries. But to prevent, as far as we can, the alarm which an argument urged on behalf of the bank is likely to excite, we will say that the bank can not refuse to pay the dividends to subsequent purchasers of these stocks. If the bank should say to such subsequent purchasers, the persons of whom you bought were not legally possessed of the stocks they sold you, the answer would be, the bank, in the books which the law requires them to keep, and for the keeping which they receive a remuneration from the public, have registered these persons as the owners of these stocks, and the bank cannot be permitted to say that such persons were not the owners. If this be not the law, who will purchase stock, or who can be certain that the stock which he holds belongs to him? It has ever been an object of the legislature to give facility to the transfer of shares in the public funds. This facility of transfer is one of the advantages belonging to this species of property, and this advantage would be entirely destroyed if a purchaser should be required to look to the regularity of the transfers to all the various persons through whom such stock had passed. Indeed, from the manner in which stock passes from man to man, from the union of stocks bought of different persons under the same name, and the impossibility of distinguishing what was regularly transferred from what was not, it is impossible to trace the title of stock as you can that of an estate. You can not look further, nor is it the practice ever to attempt to look further than the bank books for the title of the person who proposes to transfer to you."[1] This dictum expresses measurably, but not accurately, the American law. The American doctrine, applicable alike to forged or fraudulent share certificates *originally issued*, or to those *re-issued* in effecting a transfer, is that forged or fraudulent stock certificates *are not certificates*, in legal contemplation, and give no rights of their own force. Still, the act of the corporation in issuing them, they having been accepted and acted upon in good faith by another, estops the corporation from denying their validity in so far as they are

[1] Davis *v.* Bank of England, 2 Bing. 393, 407, 408.

made the foundation of a *claim for indemnity* against the corporation.[1] In other words, one who has expended money upon the faith of official certificates of stock issued by a corporation, has a right to be indemnified, to the extent of his expenditure, against loss from false certificates, but only because of such expenditure.

§ 2574. Illustration of this Principle.— In a leading English case Miss Trittin (who will be referred to as T.) was a registered holder of five shares in a registered limited joint-stock company. She left her share certificate in the hands of her broker. Not long afterwards, a transfer of her shares to S. and G., purporting to be executed by her, was left, together with her share certificate, with the secretary of the company for registration. The secretary wrote to her, in the ordinary course of business, a *notice* that the deed of transfer had been so received by him; and, receiving no answer from her, after the lapse of ten days, registered the deed of transfer, and removed her name from the registry and inserted the names of S. and G. in the place thereof, as the holders of her five shares. Thereafter A. bargained for five shares of the company's stock, in the usual way, through brokers on the stock exchange, and paid the value of them; and the five shares already referred to were transferred to him by S. and G., and his name was accordingly entered upon the registry of the company as the holder of the shares, and share certificates were issued to him. It was afterwards discovered that the transfer which purported to be from T., the original holder of the shares, to S. and G., was a forgery, and the company was ordered to restore the name of T. to its registry, by a rule of court under the statute.[3] Upon a special case stated, the court of Queen's Bench held that the giving of the certificate to S. and G. amounted to a statement by the company, intended by the company to be acted upon by purchasers of shares in the market, that S. and G. were entitled to the shares; that A., having acted upon that statement, the company were *estopped from denying its truth;* that A. was therefore entitled to recover from the company, as damages for the loss of the shares, their value at the time the company first refused to

[1] Kisterbock's Appeal, 127 Pa. St. 601; *s. c.* 14 Am. St. Rep. 868.

[2] *Ibid.; ante,* § 1493.

[3] Companies Act of 1862 (25 & 26 Vict., chap. 89), § 35, relating to what is called the "rectification of the register." That the company could not, after having once placed the name of a transferee on its register, remove it at its mere will, unless upon proof of a better title in some one else, see Ward *v.* Southeastern R. Co., 2 El. & El. 823.

recognize him as a shareholder, with interest at four per cent. from that time.[1]

§ **2575. Another Illustration.** — A modern decision which applies the doctrine thus so clearly announced by Chief Justice Best (but without citing his *dicta*) exhibited the following facts: In an action against a company for the *conversion* of the shares of the plaintiff by refusing to admit his transfer to registration, it appeared that it was the duty of the secretary of the company to procure the execution of certificates of shares in the company, through requisite and prescribed formalities, and to issue them to persons entitled to receive them. By a resolution of the directors of the company, it was provided that certificates of shares should be signed by one director, by the secretary, and also by the accountant. The secretary of the company executed a deed purporting to transfer certain shares in the company to one G., who was a purchaser of such shares, and issued to G. a certificate stating that he had been registered as the owner of the shares. This certificate was in the usual and authorized form, and was sealed with the company's seal; but the signature of the director appended thereto was in fact a forgery of the company's secretary, and the seal of the company was in fact affixed thereto without the authority of the directors. G. deposited the certificate with the plaintiff, as a security for advances, and subsequently executed a transfer of the shares to the plaintiff. Neither G. nor the plaintiff had any knowledge or reason to suspect that the certificate was other than a genuine document, or that the matters stated therein were untrue. The company refused to register the plaintiff as the owner of the shares, stating that there were no such shares standing in the name of G. on their books. It was held by Stephen and Mathew, JJ., that *the company was estopped* by the certificate, issued by their secretary, from disputing the plaintiff's title to the shares, and that judgment must be entered for the plaintiff for their value. In the course of his opinion Mr. Justice Stephen said: "The company appear in this case to have prescribed certain formalities with regard to the use of the seal and the issue of certificates. The certificate is to be signed by a director and the secretary. In the present case it apparently does comply with those formalities: it is apparently so signed, and it is stated to be in the usual and authorized form. The company made it the duty of the secretary to procure the preparation, execution and signature of certificates with the prescribed formalities, and thereupon to issue them to the persons entitled to receive them.

[1] Re Bahia &c. R. Co., L. R. 3 Q. B. 584; *s. c.* 18 L. T. (N. S.) 467; 37 L. J. (Q. B.) 176.

They thereby gave the secretary the opportunity of doing what he has done in this case. A person can inform himself whether the certificate comes from the secretary because he gets it from the secretary's office; but I do not see how, according to any practicable course of business, he can go behind the certificate and ascertain for himself such matters as whether the signature of the director is genuine. It appears to me, therefore, that the company have authorized the secretary, and made it his official duty, to act in such a way that his acts amount to a warranty by them of the genuineness of the certificate issued by him. For these reasons, I think the question put to us should be answered in favor of the plaintiff." Mr. Justice Mathew, in a separate opinion, pursued the same line of reasoning: "It seems to me," said he, "that the secretary is held out by the company as their agent to warrant the genuineness of the certificate." [1]

SUBDIVISION III. Miscellaneous Holdings.

SUBDIVISION III. Miscellaneous Holdings.

§ 2577. Liability of Corporation for Fraudulent Issues of Shares. — Restating what has been gone over in a former title,[2] if the officer of the corporation charged with the duty of issuing share certificates to its members and of transferring their shares on its books, with power to countersign, seal and issue certificates, upon surrender and cancellation of prior certificates, etc., makes a fraudulent issue the company will be bound to make it good in the form of damages.[3]

[1] Shaw *v.* Port Phillips &c. Co., 13 Q. B. Div. 107, 108.

[2] *Ante*, § 1490, *et seq.*

[3] Bank of Batavia *v.* New York &c. R. Co., 106 N. Y. 195; *s. c.* 60 Am. Rep. 440; 12 N. E. Rep. 433; Fifth Avenue Bank *v.* Forty-second Street R. Co., 17 N. Y. Supp. 826; Allen *v.*

§ 2578. Grounds of this Liability ; Respondeat Superior — Negligence — Estoppel — Ratification. — But where the fraudulent shares are not issued by the officer of the corporation intrusted with that duty, then, according to what may possibly be regarded as the American conception, the company will not be liable unless it afforded him an opportunity to commit the fraud, *through such negligence as may properly be regarded as the proximate cause of the injury;* whereas, it seems, according to the English conception, the negligence must be of such a character as to amount either to an *estoppel* or to a *ratification.* In dealing with this subject, it must, therefore, be constantly borne in mind that the *negligence* which makes the corporation liable in cases where the rule of *respondeat superior* does not apply, must at least be negligence of such a character that it can be regarded, in a legal sense, as the *proximate cause* of the injury which has happened to the party complaining. Now, there is a great deal of casuistry on the question what is proximate cause and what is remote cause in the law of damages. After much examination of the judicial authorities, and after much reflection upon the subject, the author of the present work, in dealing with the subject in reference to actions for damages for personal injuries grounded upon negligence,[1] came to the conclusion that the governing test is to consider that proximate cause is *probable cause* and that remote cause is *improbable cause.* The reason is that it is just, in a large sense, that a man who, either purposely or negligently, takes a given course of action which is wrongful and hurtful to another, ought to be held bound to pay such damages, resulting from that course of action, as a careful and prudent man ought to foresee as being likely to result from it ; and on the other hand, that the burdens of life would be intolerable if the law charged a man with liability for all the remote and improbable consequences even of his wrongful acts. Speaking with reference to the kind of negligence under consideration, the

South Boston R. Co., 150 Mass. 200; *s. c.* 15 Am. St. Rep. 185; Moores *v.* Citizens Nat. Bank, 111 U. S. 156; Boston &c. R. Co., *v.* Richardson, 135 Mass. 473; Machinists Nat. Bank *v.* Field, 126 Mass. 345; Pratt *v.* Taunton Copper Mfg. Co., 123 Mass. 110; New York &c. R. Co. *v.* Schuyler, 34 N. Y. 30, 64; Titus *v.* Great Western Tp. Co., 61 N. Y. 237, 245; Holbrook *v.* New Jersey Zinc Co., 57 N. Y. 616; Shaw *v.* Port Phillips Mining Co., 13 Q. B. Div. 103.

[1] 2 Thomp. Neg., p. 1083.

rule, then, is that the corporation will not be liable for the issue of the forged certificates, unless one of two things concur: 1. They must have been issued by its officer, appointed to issue genuine certificates, — in which case as already seen, it is, on the best judicial opinion, liable for his frauds on the public, on the principle of *respondeat superior;*[1] or 2. If they are issued by an officer not appointed to issue its certificates, but if they have negligently put it in his power to commit the forgery, then their negligence must be such that business men of ordinary prudence would be likely to foresee that such a result might happen.[2]

§ 2579. Principle Illustrated: Certificates Issued through a Forgery by the President.— In a recent case in Massachusetts, the president of a corporation, *who was not its proper officer to issue its share certificates*, but who was required to sign such certificates together with the secretary, was re-elected to his office after becoming pecuniarily irresponsible, and was allowed access to the blank certificate book of the corporation and to its corporate seal. He availed himself of these facilities to issue *forged certificates* of shares of the company, *while away from its office.* He had, with what might be regarded as the knowledge of the corporation, been guilty of previous misconduct in transferring shares of stock in his name to a third person, instead of transferring them to associate shareholders, as he had agreed to do. On these facts, it was held that the corporation was not liable for his act in issuing forged certificates, — in other words, that a *bona fide* taker of such certificates could not make the corporation respond in damages for not admitting him to registry as a shareholder. Whether this case was properly decided upon its facts is open to some doubts; but it will stand as a valuable statement of the applicatory principle of law in such cases. "On the whole," said Allen, J., after stating the case in detail, "we find nothing to show that the corporation, or its members, had reason to suppose from what Jewett [the president] had done, that he would be *likely to issue* forged certificates of shares, if allowed access to the certificate book and seal of the corporation; and, accordingly, it is not to be held responsible for his criminal fraud, as for an act made possible by its negligence."[3]

§ 2580. Forged Transfer of Name of a Co-Executor.— A recent decision in the English Court of Appeal holds that when,

[1] *Ante*, § 1495.

[2] *Post*, § 2579.

[3] Hill *v.* Jewett Pub. Co., 154 Mass. 172; *s. c.* 13 L. R. A. 193; 10 Rail. & Corp. L. J. 173; 28 N. E. Rep. 142.

under the Companies Clauses Act of 1845, § 48,[1] the names of executors of a deceased shareholder are placed on the company's register of shareholders, in respect of shares which belonged to their testator, they become *joint shareholders* in their individual capacity, although they may be described as executors in the register; and consequently that the shares can only be transferred by means of a transfer *executed by all* of them.[2] If one of them *forges* the name of the other to such a transfer, it will not pass title to the shares, and the case will stand on the same footing as any other case of a forged transfer of shares.[3]

§ 2581. The First Taker of the Original Certificate has no Right of Action against the Company. — The right of action against the company, on the principles already explained,[4] is a right of action in *bona fide sub-transferees of the new certificates* which have been issued in consequence of the forgery. The first person deceived by the forgery has, on principle, no right of action against the company for recognizing the forgery and issuing a new certificate to him; since it is his duty to discover the forgery as much as it is the duty of the company.[5] It was distinctly held by the English Court of Appeal in 1880 that the issue of the company's stock certificate under a forged transfer is not a representation by the company that the immediate transfer to the person procuring it is valid, so as to give him a right of action against the company if it proves invalid.[6]

[1] The statute relates to the manner of transferring shares to the successor in title in case of the death of the shareholder, and says nothing about joint executors.

[2] Barton *v.* London &c. R. Co., 24 Q. B. Div. 77; *ante*, § 2373.

[3] *Ibid.*

[4] *Ante*, § 2572.

[5] This is clearly brought out in Hildyard *v.* South Sea Co., 2 P. Wms. 76, where the tranferee of the shares under the forged letter of attorney was, by reason of his negligence, held to pay the cost of the suit in equity to restore the title to the real owner. See the language of the court, *ante*, § 2567.

[6] Simm *v.* Anglo-American Tel. Co. 5 Q. B. Div. 188; *s. c.*, 49 L. J. (Q. B.) 392. Compare Hart *v.* Frontino, &c. Co., 39 L. J. Exch. 93. In this last case (which is discredited by the case cited immediately before it) after a certificate of shares in a limited company had been issued to H., and he had been registered as the owner, he, on the faith of his registration, repaid to his transferor a call which the latter had paid on the shares after the sale. The company afterward removed H.'s name from the register, and substituted that of F., it having been discovered that the shares had been duly transferred previously to F. It was held that the company were

§ 2582. But the Company has a Right of Action against Him. — On the contrary, if the purchaser exhibits to the corporation a forged assignment of some of its shares, or a forged power of attorney to assign it, and thus obtains a new certificate which he sells, he is liable to the corporation, not because it is his duty to attend to the transfer of the shares, but because he has impliedly represented to the corporation that the forged signature is the genuine signature of the stockholder, whereby he has deceived the corporation.[1]

§ 2583. Rule as to Forged Commercial Paper Declared by the English Court of Appeal in the Case of the Vagliano Acceptances. —In a case which is frequently cited as the case of the Vagliano acceptances,[2] there was a series of forgeries by which the Bank of England was defrauded out of a great amount of money. These forgeries were committed under the following circumstances: V., a foreign correspondent of the plaintiff, was in the habit of drawing upon him, sometimes making the bills payable to the order of C. P. & Co., another foreign firm. G., a clerk of the plaintiff, forged the signature of V. to certain bills purporting to be drawn on the plaintiff by V. to the order of C. P. & Co. These bills resembled the genuine bills which V. was in the habit of drawing on the plaintiff. G. placed among the plaintiff's correspondence counterfeit letters of advice with respect to these forged bills, resembling the letters of advice ordinarily received by the plaintiff from V. By these means G. procured the genuine acceptances of the plaintiff to the bills which he had forged. He then forged upon the bills indorsements purporting to be those of C. P. & Co., the payees named therein, and was paid by the cashiers of the Bank of

estopped by the certificate which they had issued to H., and by the fact of his registration, from denying his title to the shares, and that he could maintain an action against them for damages for removing his name from the register. Referring to his opinion in this case, Lord Bramwell said, in the subsequent case of Simm *v.* Anglo-American Tel. Co., *supra*,— "I am afraid that I did not perceive the effect of the certificates which had been issued, and did not appreciate the judgment in Re Bahia &c. R. Co., L. R. 3 Q. B. 584; *s. c.* 37 L. J. (Q. B.) 176.

[1] Boston &c. R. Co. *v.* Richardson, 135 Mass. 473. That it is the duty of the first transferee to examine the genuineness of the transfer, and that the loss is primarily upon him, see Hambleton *v.* Central Ohio R. Co., 44 Md. 551; Brown *v.* Howard Ins. Co., 42 Md. 384; *s. c.* 20 Am. Rep. 90.

[2] Vagliano *v.* Bank of England, 22 Q. B. Div. 103; *s. c.* affirmed in Court of Appeal, 23 Q. B. Div. 243; *s. c.* reversed in the House of Lords (1891), 1 App. Cas. 107.

England across the counter the amounts for which the bills were drawn. Before the payment of the bills, the Bank of England was advised by the plaintiff, in the ordinary course of business, that the bills were coming forward for payment. On this state of case two questions arose and were considered before Mr. Justice Charles in the court below, and before the Court of Appeal on appeal from his decision: 1. Whether the Bank of England was protected by a certain section of the English Bills of Exchange Act of 1882, relating to "fictitious or non-existent payees." 2. Whether the plaintiff had been guilty of negligence such as precluded him from maintaining the action. Mr. Justice Charles held that the Bank of England was not protected by the statute; and, secondly, that the plaintiff was not precluded by his negligence from maintaining the action. On appeal, his judgment was affirmed. Five justices of the Court of Appeal held that the bank was not protected by the statute (Lord Esher, M. R., dissenting), and the whole court held that the plaintiff had not been guilty of negligence such as precluded him from maintaining the action. On a further appeal to the House of Lords, a majority of the lords held that the bank was protected by the statute, Lords Bramwell and Field dissenting. Four of the lords also held that the bank was protected by reasons turning on the conduct of the parties,— that is to say, they took the view that the plaintiff, by reason of his negligence, ought to bear the loss. Two of the lords held that the plaintiff had not been guilty of conduct which cast the loss upon him. It thus appears, from this statement of a most unsatisfactory case, that six judges and two law lords, eight judges in all, were of opinion that the plaintiff had not been guilty of such negligence as to disentitle him to maintain the action, while four law lords were of the contrary opinion, — eight judges against four, — while the case is probably to be regarded as having been decided upon a construction of the statute. The opinion of Lord Esher, M. R., in the Court of Appeal is valuable as containing a very clear statement of the rule of the law merchant which casts on the acceptor of a forged bill of exchange the burden of bearing the loss; and if, as is sometimes reasoned, the attitude of a corporation admitting to its registry the holder of a forged transfer of its shares, is similar to that of the acceptor of a forged bill of exchange, then this language has an important bearing on the question under consideration. At all events, it may be regarded in the light in which the English judges sometimes regard decisions of the American judges, — as the opinion of a professor of the common law. Lord Esher said: "The acceptor is estopped from denying the handwriting of the drawer. That has been decided. On what principle does the decision rest? By the *custom of merchants*, which has been so proved as a fact that it has, like

so many other mercantile customs, come to be accepted (without further evidence) as a fact by the court, — an acceptor is bound to know the handwriting of the drawer. The custom is rather more convenient than just. The present case is an instance in which the forgery and imitation is so perfect as to defy the most careful examination. But the custom has made the law. That being so, it must be negligence in the acceptor if he mistakes that which he is bound to know. It is, further, part of the custom of merchants that the acceptor, by accepting, represents to all into whose hands the document may *bona fide* come, that the person purporting to be the drawer is the real drawer. If, then, such a person gives value for the bill, relying upon such representation, he would be injured by such representation unless the acceptor were estopped. But where one negligently represents that to be true which is in fact false, in order that another may act upon such representation as if it were true, and the other does act upon it believing it to be true, and acts in such a way that, it being untrue, he would suffer loss or damage, if the one making the representation were allowed to rely on the untruthfulness, the one making the representation is by the law estopped from averring the untruthfulness against the other. This is a general rule of the law of estoppel. The facts being ascertained, the law declares the estoppel. And when once the estoppel is effectual, the transaction between the two parties is to be treated as it would be if the representation had been true. In the given case the transaction is, as between the *bona fide* endorsee for value and the acceptor, though not as between any other persons, to be treated as if the person purporting to be the drawer was in truth the drawer. If there is no other defect in the supposed bill, the acceptor is in such a case liable to pay the endorsee the amount of the bill."[1]

[1] Vagliano *v.* Bank of England, 23 Q. B. Div., at pp. 249, 250.

CHAPTER XXXVIII.

BONA FIDE PURCHASERS OF SHARES.

Article I. In General.

§ 2587. Certificates of Stock not Negotiable.— Certificates of stock are not negotiable paper in the full sense of the term.[1] "The most that can be said is, that such instruments possess a *quasi*-negotiability, dependent upon the customs of merchants and the convenience of trade. They are not, in the matter of

[1] Hall *v.* Rose Hill &c. R. Co., 70 Ill. 673; Mechanics Bank *v.* New York &c. R. Co., 13 N. Y. 627; Weaver *v.* Barden, 49 N. Y. 286; Winter *v.* Belmont Mining Co., 53 Cal. 428; Sherwood *v.* Meadow Valley Mining Co., 50 Cal. 412, followed in Barstow *v.* Savage Mining Co., 64 Cal. 392. Compare the following cases in New York: Moore *v.* Metropolitan Bank, 55 N. Y. 41; *s. c.* 14 Am. Rep. 173; overruling Bush *v.* Lathrop, 22 N. Y. 535; McNeil

transferability, protected strictly as negotiable paper."[1] Corporate shares are sometimes said to be *choses in action;*[2] and it has been said that when one purchases or acquires stock in a corporation, no matter at what time, he acquires a fractional interest in the capital stock, assets, profits and liabilities of the corporation.[3] The share certificate is merely the *documentary evidence*, furnished by the corporation to the shareholder of this collection of incorporeal rights. It has therefore come to be regarded as the *symbol* of the shares, and is confused in popular, and often in legal contemplation, with the property which it represents.

§ 2588. Usage of Regarding them Negotiable not Good. — It being an established principle of law that certificates of stock are not to be regarded as negotiable paper, it is not permissible to prove a *custom or usage* among stockbrokers to the contrary, — the reason being that no usage is good which conflicts with an established principle of law, any more than one which contravenes or nullifies the express stipulations of a contract.[4] "No commercial usage," it has been said, "can give to such an instrument the attribute of negotiability. However many intermediate hands it may pass through, whoever would obtain a new certificate in his own name must fill out the blanks * * * so as to derive title to himself, directly from the last recorded stockholder, who is the only recognized and legal owner of the shares."[5]

v. Tenth Nat. Bank, 46 N. Y. 325; *s. c.* 7 Am. Rep. 341.

[1] East Birmingham Land Co. *v.* Dennis, 85 Ala. 565, 567; *s. c.* 7 Am. St. Rep. 73; 28 Cent. L. J. 402, opinion by Somerville, J. Shaw *v.* Spencer, 100 Mass. 382, 388; *s. c.* 1 Am. Rep. 115. See also Sewall *v.* Boston Water Power Co., 4 Allen (Mass.), 277, 282; *s. c.* 81 Am. Dec. 701. For the same rule as to *bills of lading*, see Gurney *v.* Behrend, 3 El. & Bl. 622.

[2] *Ante*, § 1070.

[3] Barrick *v.* Gifford, 47 Oh. St. 180; *s. c.* 21 Am. St. Rep. 798. This is not meant in the sense that shareholders are co-owners; *ante*, § 1071.

[4] East Birmingham Land Co. *v.* Dennis, 85 Ala. 565; *s. c.* 7 Am. St. Rep. 73; 28 Cent. L. J. 402; Shaw *v.* Spencer, 100 Mass. 382; *s. c.* 1 Am. Rep. 115. That a custom or usage contrary to law will not be recognized, see Dickinson *v.* Gay, 7 Allen (Mass.), 29; *s. c.* 83 Am. Dec. 656; Cranwell *v.* Ship Fosdick, 15 La. An. 436; *s. c.* 77 Am. Dec. 190; Beirne *v.* Dord, 5 N. Y. 95; *s. c.* 55 Am. Dec. 321; Cox *v.* O'Riley, 4 Ind. 368; *s. c.* 58 Am. Dec. 633; Harris *v.* Carson, 7 Leigh (Va.), 632; *s. c.* 30 Am. Dec. 510; Lehman *v.* Marshall, 47 Ala. 362.

[5] Shaw *v.* Spencer, 100 Mass. 382; *s. c.* 97 Am. Dec. 107; 1 Am. Rep. 115.

§ 2589. **But are Quasi-Negotiable.** — But a little reflection will make it appear that there is an essential difference in this respect between share certificates and tangible personal property. If A. delivers his horse to B., the act is, in the absence of explanation, just as consistent with the conclusion of a bailment as with the conclusion of a sale. But if A., being the holder of certificates of stock, indorses them in blank in the usual mode and delivers them to B., the act is more consistent with the conclusion of a sale or pledge, than with the conclusion of a mere bailment. The transferee stands in a position somewhat similar to that of the transferee of a promissory note payable to bearer. His position is different from that of the one to whom the horse has been delivered in this: a muniment of title has been delivered to him, which he may perfect into a legal title by pursuing certain formalities. The delivery of it to him with a power of attorney indorsed upon it in blank enables it to pass from hand to hand by mere delivery, and enables the final purchaser who wishes to perfect his legal title to it to do so by appointing an attorney to make the transfer to him on the books of the corporation, — that is to say, by filling out the blank. But most business men, in conformity with a settled general usage, have come to regard such certificates as partaking very nearly of the character of negotiable notes or bonds, which, by mere delivery, pass from hand to hand the debts which they evidence. It was proved in one case that it was the custom in the city of New York that share certificates so indorsed in blank should pass from hand to hand by delivery,[1] and courts, which take judicial notice of the usages of trade,[2] will no doubt take notice that such is the custom of trade throughout the whole country. The conclusion, then, is, as said by Mr. Justice Davis, that certificates of stock "although neither in character nor form negotiable paper, approximate to it as nearly as practicable."[3]

To the same effect, see East Tennessee &c. R. Co. *v.* Johnston, 75 Ala. 596; Lehman *v.* Marshall, 47 Ala. 362.

[1] Merchants National Bank *v.* Richards, 6 Mo. App. 454, 461.

[2] Greenl. Evid., 15th Ed., § 5; Gregory *v.* Wendell, 39 Mich. 337; *s. c.* 33 Am. Rep. 390; Davis *v.* Hanly, 12 Ark. 645.

[3] Bank *v.* Lanier, 11 Wall. (U. S.) 377. See also Kortright *v.* Commercial Bank, 20 Wend. 91; Commercial

§ 2590. Grounds upon which the Courts Uphold their Semi-Negotiable Quality. — The grounds on which the courts proceed in upholding this semi-negotiable quality of corporate shares was thus expressed, with regard to national bank shares, in a case in the Supreme Court of the United States, by Mr. Justice Davis: "The power to transfer their stock is one of the most valuable franchises conferred by Congress upon banking associations. Without this power, it can readily be seen, the value of the stock would be greatly lessened; and obviously, whatever contributes to make the shares of stock a safe mode of investment, and easily convertible, tends to enhance their value. It is no less to the interest of the shareholder than the public that the certificate representing his stock should be in a form to secure public confidence; for without this he could not negotiate it to any advantage. It is in obedience to this requirement that stock certificates of all kinds have been constructed in a way to invite the confidence of business men, so that they have become the basis of commercial transactions in all the large cities of the country, and are sold in open market the same as other securities. Although neither in form nor character negotiable paper, they approximate to it as nearly as practicable. If we assume that the certificates in question are not different from those in general use by corporations (and the assumption is a safe one), it is easy to see why investments of this character are sought after and relied upon. No better form could be adopted to assure the purchaser that he can buy with safety. He is told, under the seal of the corporation, that the shareholder is entitled to so much stock, which can be transferred on the books of the corporation in person or by attorney, when the certificates are surrendered, but not otherwise. This is a notification to all persons interested to know that whoever in good faith buys the stock, and produces to the corporation the certificates, regularly assigned, with power to transfer, is entitled to have the stock transferred to him. And the notification goes further, for it assures the holder that the corporation will not transfer the stock to any one not in possession of the certificates.[1]

Bank *v.* Kortright, 22 Wend. (N. Y.) 348; *s. c.* 34 Am. Dec. 347; McNeil *v.* Bank, 46 N. Y. 325; *s. c.* 7 Am. Rep. 341; Mathews *v.* Bank, 1 Holmes (U. S.), 396; Johnson *v.* Laflin, 5 Dill. (U. S.), 65; Compare Fisher *v.* Essex Bank, 5 Gray (Mass.), 373; Sargent *v.* Essex Railway, 9 Pick. (Mass.) 205; Union Bank *v.* Laird, 2 Wheat. (U. S.) 390. There is a learned note on this subject in 19 Am. & Eng. Corp. Cas. 478. For the reason that corporate stocks are articles of commerce, passing from hand to hand like commercial paper, the doctrine of constructive notice by *lis pendens* is not applicable to them. Leitch *v.* Wells, 48 N. Y. 585.

[1] Lanier *v.* Bank, 11 Wall. (U. S.) 369, 377; quoted with approval in Sup-

§ 2591. View that Bona Fide Purchaser Takes only Title of his Vendor. — From the premise that certificates of stock are not negotiable paper, the conclusion would naturally follow that a *bona fide* assignee of such certificates takes them subject to the equities which exist against the assignor.[1] Under this theory an unregistered assignment will not pass title as against *creditors* of the assignor,[2] nor as against *subsequent purchasers* from him without notice,[3] nor as against the *lien of the corporation* on the shares for the indebtedness of the stockholder.[4] A qualified statement of this rule is that an innocent purchaser for value of a certificate of corporate shares of stock, although indorsed in blank by the owner, obtains no better title to the stock than his vendor had, *in the absence of negligence* on the part of the owner.[5] Under this rule the transfer of shares stands on the same footing as an assignment of a merchant's account, a non-negotiable note, or any other species of personal property. With this premise in mind, it is sometimes laid down by judges in general terms that the purchaser in good faith of corporate shares gets no higher title than his vendor had to convey.[6] This is the general rule with regard to sales of personal property,[7] other than negotiable securities, at least in America, where there is no *market overt;* and it is the *English rule* with regard to sales of shares. In a recent English case Mr. Justice Chitty, in dealing with this subject, used this language: "Estoppels can not be manufactured arbitrarily; no estoppel can be raised on a document inconsistent with the terms of the document itself. What then, is the estoppel here? Having regard to the practice proved, and the condition in which these documents are when they pass from hand to hand, the right principle to adopt with

ply Ditch Co. *v.* Elliott, 10 Colo. 327, 333; *s. c.* 3 Am. St. Rep. 586, 591, and in many other cases.

[1] Perhaps the ablest presentation of this view is found in the powerful opinion of Comstock, J., in Mechanics Bank *v.* New York &c. R. Co., 13 N. Y. 599, 623, which is understood not to express the present law of New York on this subject; *post*, § 2593.

[2] *Ante*, § 2409; Blanchard *v.* Dedham Gaslight Co., 12 Gray (Mass.), 215.

[3] Pinkerton *v.* Manchester &c. R. Co., 42 N. H. 427.

[4] Union Bank *v.* Laird, 2 Wheat. (U. S.) 390.

[5] East Birmingham Land Co. *v.* Dennis, 85 Ala. 565; *s. c.* 7 Am. St. Rep. 73.

[6] Young *v.* South Tredegar Iron Co., 85 Tenn. 189; *s. c.* 4 Am. St. Rep. 752.

[7] Mechanics Bank *v.* N. Y. &c. R. Co., 13 N. Y. 599.

reference to them is to hold that where (as in the case before me) the transfers are duly signed by the registered holders of the shares, each prior holder confers upon the *bona fide* holder for value of the certificates for the time being an authority to fill in the name of the transferee, and is estopped from denying such authority; and to this extent, and in this manner, but not further, is estopped from denying the title of such holder for the time being."[1] Commenting on this language, it was said by Lindley, L. J.: "If Mr. Justice Chitty means by the expression, *bona fide* holder for value of the certificates, somebody distinguishable from the person entitled to the certificates, I doubt whether he is not putting it a little too far, a little further than the language of the document warrants; but if, as I understand it, he means by *bona fide* holder the person entitled to the certificate, then I think he is perfectly correct."[2] This, it will be perceived, takes every element of estoppel out of the act of a shareholder in delivering his share certificate to another after having signed a blank transfer thereon, and throws the English law into very clear contrast with the American law on this question.[3] The principle of the English law is well illustrated by a case where the owner of shares pledged them by delivering the certificates with a blank assignment and power of attorney, and his pledgee repledged them for a larger amount, and the second pledgee procured them to be transferred to himself on the books of the company. It was held by the English Court of Appeal that the second pledgee took no higher interest in them than the right to hold them as security for the amount borrowed of his pledgor by the original owner of them.[4] Under this rule the transferee acquires no better title than his transferor, unless the true

[1] Colonial Bank *v.* Hepworth, 36 Ch. Div. 36.

[2] Williams *v.* Colonial Bank, 38 Ch. Div. 388, 407.

[3] To the same effect see The London & County Bank *v.* London & River Plate Bank, 20 Q. B. Div 232.

[4] France *v.* Clark, 26 Q. B. Div. 257; affirming *s. c.* 22 Ch. Div. 830; distinguishing Ex parte Sargent, L. R. 17 Eq. 273. The principle which denies the quality of negotiability to share certificates does not operate, in the English law, on the *scrip of foreign governments.* This scrip is, by the custom of all the stock-markets of Europe, a negotiable instrument, passing by mere delivery to *bona fide* purchasers for value. The English law follows this custom; and hence any person taking such scrip in good faith obtains a title to it which is not affected by the title of his transferor. Goodwin *v.* Robarts (H. L.), 1 App. Cas. 476.

owner has in some way *estopped* himself from setting up his title against the transferee.[1] Thus, it has been held in that country that the conduct of executors in delivering to a broker transfers of stock without filling out blank powers of attorney was consistent either with an intention to sell or pledge the shares, or to have themselves registered as the owners, and therefore did not estop them from setting up their title as against a bank to which he had fraudulently transferred them, for the bank ought to have inquired into the broker's authority.[2]

§ **2592. This View Illustrated.** — The general rule is that one who purchases personal property from a *thief* (except in England, in *market overt*) gets no title. This principle applies to all kinds of personal property, except to money and negotiable securities. A certificate of corporate stock does not form an exception to this rule.[3] It has been held to apply in a case where one having no title to shares of corporate stock *purloins the certificate* and, for a valuable consideration, transfers it to an innocent third party.[4] - - - - The English executors of an English holder of shares in an American railroad, in order that the shares might be registered in their names, so as to enable them to receive the dividends, and if necessary to sell, signed blank transfers with powers of attorney indorsed on the share certificates and gave them to their brokers in London. The brokers fraudulently deposited them with a London bank, as security for advances made to themselves, and aftewards became bankrupt. According to American law the certificates were not negotiable instruments, but the rightful holder of them, with the indorsed transfers signed, was entitled to be registered as holder. By the practice of the railway company, it was required that the signatures of executors to an indorsement should be attested by a consul, which had not been done, and without this they were not regarded on the stock exchange as duly indorsed, though the want of this attestation would not prevent registration if the company

[1] Williams *v.* Colonial Bank, 38 Ch. Div. 388, 399. Compare Duggan *v.* London &c. L. & A. Co., 18 Ont. App. 305; *s. c.* 34 Am. & Eng. Corp. Cas. 641, overruling 19 Ont. Rep. 272; *s. c.* 30 Am. *v.* Eng Corp. Cas. 89; *ante*, § 2758.

[2] Colonial Bank *v.* Cady, 15 App. Cas. 267; *s. c.* 8 Rail & Corp. L. J. 282.

[3] Barstow *v.* Savage Mining Co., 64 Cal. 388; *s. c.* 49 Am. Rep. 705; distinguishing or denying Winter *v.* Belmont Mining Co., 53 Cal. 428; following Sherwood *v.* Meadow Valley Mining Co., 50 Cal. 412. See also East Birmingham Land Co. *v.* Dennis, 85 Ala. 565; *s. c.* 7 Am. St. Rep. 73; 2 L. R. A. 836; 5 Rail. & Corp. L. J. 296; 28 Cent. L. J. 402; 5 So. Rep. 317.

[4] Anderson *v.* Nicholas, 28 N. Y. 600.

were satisfied otherwise of the genuineness of the signatures. There was some evidence that, under the circumstances of the case, the bank would, in America, have been held entitled to be registered, on the ground that the executors had *estopped* themselves from disputing the titles of the holders of the certificates. It was held, that as the certificates did not represent, on the face of them, that the person in possession of them would be entitled to the shares, and the absence of attestation by a consul made the transfer not in order, and was sufficient to put a party dealing with the brokers on inquiry, the executors were not estopped, and must be held entitled to the shares as part of their testator's estate.[1] This is a very instructive case, and the part of the argument in the opinion of Lord Justice Lindley was that share certificates might be negotiable under the American law (which he did not believe), yet when they were sent over to England they were not negotiable under the law of England. He said, illustrating his opinion: "The Prussian thaler is current in Prussia, but is not current in London; nor because a negotiable instrument is current in one country and part of the cash of that country, is it therefore a negotiable instrument or part of the cash of England."[2] Stress was laid, however, upon the proposition that the documents were not in order, by which was meant that they were not in the shape in which mercantile men will take them without inquiry. Such being the case, it was held that the transferees had no title to the certificates except on the ground of an estoppel; "and how can they avail themselves of estoppel when they are put upon inquiry by the very document upon which they rely?"[3]

§ 2593. Contrary View where the Certificate is Delivered with Blank Power of Attorney, etc. — A contrary rule is recognized by many American courts,[4] in the case where the rightful owner of the shares in whose name they stand on the corporate books, has indorsed a transfer upon the certificates in blank and signed a blank power of attorney indorsed thereon, and in this condition delivered them. Here he invests the transferee with the usual evidences of title, as much as he would if he were to deliver to him his horse with a bill of sale of the same. In all such cases, the rightful owner, having invested another with the usual evidence of title, or an apparent authority

[1] Williams *v.* Colonial Bank, 38 Ch. Div. 388; *s. c.* 57 L. J. (Ch.) 826; 59 L. T. (N. S.) 643; 36 Week. Rep. 625.

[2] *Ibid.* 38 Ch. Div., at page 404.

[3] *Ibid.* 407.

[4] As to the English holdings, see *ante*, § 2565, *et seq.*

to dispose of the shares, will be *estopped* from making any claim against an innocent purchaser dealing upon the faith of such apparent ownership or right of disposition.[1] "Certificates of stock," it has been said, "are assignable, and pass from hand to hand by indorsement, as bills of exchange and promissory notes pass; and holders of such certificates are *prima facie* presumed to be the *bona fide* owners thereof, and an innocent purchaser thereof for value will hold them against the true owner, where the latter has placed it in the power of the assignor to perpetrate a fraud upon the innocent assignee."[2] If, therefore, the corporation is thus induced to *issue new certificates* of shares in the place of old ones, to facilitate a division and sale, a purchaser of one of the new certificates in good faith, for value and without notice of any infirmity connected with it, will get a good title.[3] The theory of the courts which uphold this line of doctrine is that statutory or other provisions that the shares shall be *transferable on the books of the company*, are *for the benefit of the company* merely, and do not extend to the protection of the general public, of third parties,[4] or even of the shareholders.[5] If the corporation assent to such transfer otherwise than on the books, and by such transfer the persons to whom it is transferred become stockholders, no objection can be made by the corporation, nor by the stockholder as long as he is in fact a stockholder.[6]

[1] McNeil *v.* Tenth Nat. Bank, 46 N. Y. 325; *s. c.* 7 Am. Rep. 341; Williams *v.* Fletcher, 129 Ill. 356; *s. c.* 21 N. E. Rep. 783; Dodds *v.* Hills, 2 Hen. & M. (Va.) 424; Winter *v.* Montgomery Gaslight Co., 89 Ala. 544; *s. c.* 7 South. Rep. 773; 8 Rail. & Corp. L. J. 244; Nutting *v.* Thomason, 46 Ga. 34; Brewster *v.* Sime, 42 Cal. 139; Bank *v.* Wayman, 5 Gill (Md.), 336; Burton *v.* Peterson, 12 Phila. (Pa.) 397; Stinson *v.* Thornton, 56 Ga. 377; Weaver *v.* Barden, 49 N. Y. 286 (collecting the authorities); Mount Holly &c. Co. *v.* Ferree, 17 N. J. Eq. 117; Walker *v.* Detroit &c. R. Co., 47 Mich. 338. So enacted by statute in New Hampshire: N. H. Act Aug. 10, 1887; Laws 1887, ch. 16, p. 417.

[2] Supply Ditch Co. *v.* Elliott, 10 Colo. 327; *s. c.* 3 Am. St. Rep. 586, 591. See also Lanier *v.* Bank, 11 Wall. (U. S.) 369.

[3] Caulkins *v.* Gaslight Company, 85 Tenn. 683; *s. c.* 4 Am. St. Rep. 786; citing Cherry *v.* Frost, 7 Lea (Tenn.), 1; Cornick *v.* Richard, 3 Lea (Tenn.), 1.; *ante*, § 2572, *et seq.*

[4] Insurance Co. *v.* Goodfellow, 9 Mo. 150; Choteau Spring Co. *v.* Harris, 20 Mo. 382; United States *v.* Cutts, 1 Sumn. (U. S.) 138; Bank of Utica *v.* Smalley, 2 Cow. (N. Y.) 770; *s. c.* 14 Am. Dec. 526.

[5] Joslyn *v.* St. Paul Distilling Co., 44 Minn. 183; *s. c.* 46 N. W. Rep. 337.

[6] Smock *v.* Henderson, 1 Wilson (Ind.), 241.

§ 2594. **When Unregistered Transfers Subject to the Equity of the Corporation.** — Where there is a power, either in the corporation at large or in its directors, to regulate the transfer of its stock, they may require, by *by-law*, the transfer to be made on the books of the company; and in that case the title of a purchaser before the transfer is entered on the books, although good between him and the vendor, *is not a legal but an equitable title merely*, and, being no more than an equity, will be subject to the prior equity, if any, of the corporation. In other words, the assignee merely steps into the shoes of the assignor and takes no greater title or right than he has.[1] Under this theory, he *takes the risk* that the equitable title is such as will enable him to compel a legal transfer.[2] Opposed to this, are holdings to the effect that a transfer of shares by one to a *bona fide* purchaser for value, vests the title in the purchaser free from equities between the seller and the corporation of which the purchaser was ignorant at the time of the transfer, though provided for by a *by-law* of the corporation. The fact of the existence of such a by-law is not enough to charge him with notice. The power of corporations to make by-laws governing the transfer of their stock, does not include the power to create laws thereon affecting purchasers for value without notice.[3] The "*charter*" of a corporation organized under a general law *in Louisiana* seems to be the same as the articles of association where the corporation is organized under a general statute in other States. Such a "charter," it has been held, can not create a lien in favor of the corporation upon the shares of its members for debts due by them to the corporation, unless the creation of such a lien is authorized by the general law, which it is not.[4] Under the civil code of California, § 324, providing that a transfer of stock by

[1] Union Bank *v.* Laird, 2 Wheat. (U. S.) 393; Lockwood *v.* Mechanics Nat. Bank, 9 R. I. 308; *s. c.* 11 Am. Rep. 253, 264; Stebbins *v.* Phœnix Ins. Co., 3 Paige (N. Y.), 361; Vansands *v.* Middlesex County Bank, 26 Conn. 144. For opposing theories on this subject, see *ante*, § 2507, *et seq.*

[2] Wood *v.* Maitland, 10 Phila. (Pa.), 84.

[3] Anglo-Californian Bank *v.* Granger's Bank, 63 Cal. 359; Bullard *v.* Bank, 18 Wall. (U. S.) 589; Driscoll *v.* West, Bradley &c. Co., 59 N. Y. 96.

[4] New Orleans National Banking Association *v.* Wiltz, 10 Fed. Rep. 330. So held in regard to a by-law. Bryon *v.* Carter, 22 La. An. 98.

indorsement, and delivery of the certificate, "is not valid, except between the parties, until the same is entered on the books," an assignee of the certificate, according to a later holding in that State, takes subject to the bank's equity, and, as the condition is sufficient to put him on inquiry, he is not a *bona fide* purchaser.[1]

2595. Exception that Corporation Estopped to Deny Validity of Certificates Formally Issued. — A corporation is estopped to deny the validity of stock certificates issued in proper form and under its seal, and duly signed by its officers *authorized to issue certificates*, as against holders of such certificates who have taken them for value without knowledge that they had been fraudulently issued, or without being in possession of such facts as should have put a careful and fair-minded man upon such an inquiry as would have led to the discovery of such facts.[2] Hence a purchaser of corporate shares, receiving *new certificates* therefor, *signed by the proper officers*, although issued through their fraud, is, if he acts in good faith, entitled to be protected as a *bona fide* purchaser.. He owes no duty to the corporation to see to it that the seller surrenders any old certificates and transfers them on the books of the corporation.[3] The reason is that stock certificates constitute a *continuing affirmation* by the corporation of the ownership of the stated amount of stock by the person designated therein or his assignee; and the purchaser has a right to rely thereon and claim the benefit of an estoppel against the corporation.[4] When, therefore, stock

[1] Jennings *v.* Bank of California, 79 Cal. 323, 331; *s. c.* 12 Am. St. Rep. 145; 21 Pac. Rep. 852. Compare Anglo-Californian Bank *v.* Granger's Bank, 63 Cal. 359.

[2] *Ante*, §§ 1494, 1681, 2517, 2572; Machinists Nat. Bank *v.* Field, 126 Mass. 345; Boston &c. R. Co. *v.* Richardson, 135 Mass. 473; Pratt *v.* Taunton Copper Co., 123 Mass. 110; *s. c.* 25 Am. Rep. 37; Allen *v.* South Boston R. Co., 150 Mass. 200; *s. c.* 15 Am. St. Rep. 185; New York &c. R. Co. *v.* Schuyler, 34 N. Y. 30, 64; Holbrook *v.* New Jersey Zinc Co., 57 N. Y. 616; Shaw *v.* Fort Philip Mining Co., 13 Q. B. Div. 103; Mechanics' Savings Institution *v.* Potthoff, 9 Mo. App. 574; Lee *v.* Citizens National Bank, 2 Cin. (Ohio) 298; Kisterbock's Appeal, 127 Pa. St. 601; *s. c.* 14 Am. St. Rep. 868.

[3] Allen *v.* South Boston R. Co., 150 Mass. 200; *s. c.* 15 Am. St. Rep. 185; 5 L. R. A. 716.

[4] Kisterbock's Appeal, 127 Pa. St. 601; *s. c.* 14 Am. St. Rep. 868; 24 W. N. C. 446; 18 Atl. Rep. 381; 46 Phil. Leg. Int. 517; Holbrook *v.* New Jersey Zinc Co., 57 N. Y. 616; Re Bahia &c. R. Co., L. R. 3 Q. B. 585; Bank of

was issued on the vote of directors, and used by them as a pledge to obtain a loan, the corporation was held estopped from setting up that the issue of unpaid stock is prohibited by the constitution, and the holder was entitled to the same to the extent of the loan.[1] After there has been a surrender of the old certificate to the corporation to effect a transfer,[2] and an issue by the corporation of a new certificate to the holder of the old, and the new certificate has passed into the hands of a *bona fide* purchaser, there has been in law a change of title to the shares: the new purchaser will hold the certificate as against the world;[3] though, as already stated,[4] the corporation may be liable to the original owner for a conversion.[5]

§ 2596. Thus, Corporation Liable for Fraudulent Over-Issues. — A corporation is liable *in damages* where a certificate of its capital stock is issued to a *bona fide* purchaser *by its treasurer*, with whom blank certificates, signed by its president, have been left, though all of the stock which the corporation is entitled to issue has been previously issued, and although the treasurer fraudulently issued the certificate in question to effect some purpose of his own. Nor does the fact that the certificate thus issued was transferable on the books of the company only on the surrender of the old certificate, and that no old certificate was ever surrendered, relieve the corporation from liability, if the purchaser of the stock paid full value for it and otherwise acted in good faith.[6] Such a certificate is *not indeed a genuine certificate*, and does not give to the holder the rights of a shareholder; it merely gives to him the right to be indemnified by the corporation to the extent of his expenditure on the faith of it.[7]

Kentucky *v.* Bank, 1 Pas. Sel. Cas. 180. See also Jefferson *v.* Burford (Ky.), 13 Ky. L. Rep. 650; 17 S. W. Rep. 855.

[1] Gasquet *v.* Crescent City Brewing Co., 49 Fed. Rep. 496.

[2] *Ante*, §§ 2378, 2501.

[3] Machinists Nat. Bank *v.* Field, 126 Mass. 345; Mandlebaum *v.* North A. M. Co., 4 Mich. 465; Pratt *v.* Taunton &c. Co., 123 Mass. 110; *s. c.* 25 Am. Rep. 37.

[4] *Ante*, § 2489.

[5] Winter *v.* Montgomery Gaslight Co., 89 Ala. 544; *s. c.* 7 So. Rep. 773.

[6] Allen *v.* South Boston R. Co., 150 Mass. 200; *s. c.* 15 Am. St. Rep. 185; 5 L. R. A. 716; 22 N. E. Rep. 917; *ante*, § 1493.

[7] Kisterbock's Appeal, 127 Pa. St. 601; *s. c.* 14 Am. St. Rep. 868; 18 Atl. 381. See also Jeane's Appeal, 116 Pa. St. 573; *s. c.* 2 Am. St. Rep. 624; Wright's Appeal, 99 Pa. St. 425.

§ 2597. Effect of a Pledge of Such a Certificate. — If such a certificate is given in pledge to an innocent taker, the thing pledged is not shares of stock, but merely a right to call upon the corporation for indemnity against any loss suffered in consequence of relying upon its representation, contained in the share certificate, that the person named therein is entitled to the shares of stock therein named.[1] It has been held that if a fraudulent certificate is pledged by one who has no claim to indemnity thereon, and the pledgee receives from the corporation, in settlement of his claim to be indemnified for his advances made on the faith of the pledge, genuine shares of stock, surrendering the spurious shares so pledged, such genuine shares do not become a substituted pledge in his hands, but are his absolutely. It follows that a pledgor of such a certificate, who has himself no claim to be indemnified thereon, is not entitled to recover from his pledgee, who advanced money to him on the faith of it, any part of what the latter may have received from the corporation upon his claim for indemnity, although such claim may have been paid in genuine shares which afterwards increased in value to an amount exceeding the debt of the pledgor to the pledgee.[2] It has been held that if a man is the innocent holder of share certificates which the corporation is entitled to treat as spurious, and he pledges such certificates for a loan, and the corporation afterwards induces him to repurchase them, it does not thereby estop itself from disputing their validity in his hands; because he, in pledging them, impliedly warranted their genuineness.[3]

§ 2598. Corporation Estopped by its Books. — A corporation is estopped by its books in favor of an innocent purchaser of its shares for value. Hence a *bona fide* transferee of shares, which the books of the corporation show to be paid up, is not liable for any alleged deficiency in the consideration received by the corporation for it, of which he had no notice.[4] It follows

[1] Kisterbock's Appeal, 127 Pa. St. 601; *s. c.* 14 Am. St. Rep. 868; 18 Atl. Rep. 381; 46 Phila. Leg. Int. 517.

[2] *Ibid.*

[3] Cincinnati &c. R. Co. *v.* Citizens Nat. Bank (Super. Ct. Cin.), 24 Oh. L. J. 198, opinion by Taft, J.

[4] Mallinckrodt Chemical Works *v.* Belleville Glass Co., 34 Ill. App. 404, 413; *ante*, § 1680, *et seq.*

that *bona fide* purchasers of stock in a corporation, which was paid for by the subscriber in land, while the charter of the company allowed it to take real estate for stock, cannot be held liable for any difference between the actual value of the land and the price at which it was taken, especially where it is impossible to restore the parties to the original condition, because coal in the mine has been largely mined out of it.[1]

§ 2599. **Purchasers not Bound to Look Beyond the Face of the Share Certificate.**— Where the shares of a corporation are offered for sale by the person named in the certificate, an intending purchaser is not required to look beyond the recitals of the certificate in regard to his title or the equities of the corporation, or to suspect fraud in the issuing of the shares, where all seems fair and honest. He is not bound to examine the books of the corporation to ascertain the validity of a transfer.[2] The reason arises from the nature of a share certificate, which, as already stated, is a continuing affirmation of the ownership of the specified amount of stock by the person designated therein, or his assignee, until it is withdrawn in some manner recognized by law; and a purchaser in good faith has a right to rely thereon and to claim the benefit of an estoppel in his favor as against the corporation.[3] Accordingly, it has been held that a corporation whose certificate of stock is outstanding cannot defeat the title of a purchaser in good faith without actual notice, by proof of the pendency of an action in a competent court of New York, to determine the title of the original holder to the stock. Its own positive statements in the certificate cannot be overcome by such a constructive theoretical notice.[4] For the same reason a purchaser of corporate stock receiving new certificates therefor, signed by the proper officers, although issued through their fraud, is, if he acts in good faith, entitled to be protected as a

[1] Du Pont *v.* Tilden, 42 Fed. Rep. 87; *s. c.* 8 Rail. & Corp. L. J. 28; Keystone Bridge Co. *v.* McCluney, 8 Mo. App. 500; Brandt *v.* Ehlen, 59 Md. 1.

[2] Lowry *v.* Commercial &c. Bank *v.* Taney (U. S.), 310; Forman *v.* Bigelow, 4 Cliff. (U. S.) 508; Salisbury Mills *v.* Townshend, 109 Mass. 115; Bayard *v.* Farmers Bank, 52 Pa. St. 232.

[3] Holbrook *v.* New Jersey Zinc Co., 57 N. Y. 616. This principle is recognized in Hall *v.* Rose Hill &c. Co., 70 Ill. 673.

[4] Holbrook *v.* New Jersey Zinc Co., 57 N. Y. 616.

bona fide purchaser. He owes no duty to the corporation to see to it that the seller surrenders any old certificates and transfers them on the books of the corporation.[1]

§ 2600. Rule Limited to Cases where the Certificate has been Issued by the Corporate Officer Empowered to Issue Certificates. — By parallel reasoning the corporation should be held liable where, through its negligence, it suffers its share certificates, formally filled out, signed and sealed, to get out upon the market where they may operate to deceive innocent purchasers; and this is probably the American rule. But where the certificates were not issued by the corporate officer empowered to issue them, but were issued by *its president*, who has no such power, but who made use of the facilities afforded by his office to get possession of some blank certificates which had been signed, and also of the corporate seal, which he had affixed to them, and then fraudulently issued them for his own purposes, it was held that the certificates so issued stood on the footing of *forged certificates*,[2] and that they did not estop the corporation; and further that the corporation had not been negligent in permitting its president to continue in office and have access to its certificate book and seal in such a sense as to make it liable for his act in issuing the certificates, although it knew of his former misconduct in pledging his own shares to another person in violation of an agreement to pledge them to an associate, and that he was insolvent.[3] Similarly, it has been held that it is not within the apparent scope of the authority of the secretary of a corporation, to issue stock certificates directly as belonging to himself; and his representations that they represent real transactions, implied from the fact of their issuance, will not estop the company to deny their validity.[4]

§ 2601. Extent of Right of Corporation to Treat Registered Shareholder as Actual Owner. — The rule that a corporation, acting in good faith and without notice of the rights of

[1] Allen *v.* South Boston R. Co., 150 Mass. 200; *s. c.* 15 Am. St. Rep. 185; 5 L. R. A. 716.

[2] As to which see *ante*, § 1490, *et seq.*

[3] Hill *v.* Jewett Pub. Co., 154 Mass. 172; *s. c.* 13 L. R. A. 193; 10 Rail. & Corp. L. J. 173; 28 N. E. Rep. 142.

[4] Cincinnati &c. R. Co. *v.* Citizens Nat. Bank (Super. Ct. Cin.), 24 Ohio L. J. 198, opinion by Taft, J.

others, may treat its registered shareholders as the actual owners of the shares standing in their name, applies only to such transactions as are within the express or implied powers conferred upon the company or its shareholders collectively; and an assignee of shares having possession of a certificate, although holding under an unregistered transfer, is not bound by a contract between the registered shareholder and the corporation, which is not within such powers. When, therefore, after an assignment of a certificate of shares, which assignment was not registered, all the other shareholders, with the assignor and the corporation, entered into an agreement, giving certain of the shares, which were surrendered by the shareholders to be sold to pay the debts of the corporation, priority in dividends over the other shares, under which agreement new certificates were to be issued in lieu of the shares retained, which by their terms were made subject to a first lien on the net profits thereby given to the surrendered shares, — it was held that this agreement was not binding on the assignee, and that he was entitled, on surrender of the assigned certificate, to an unconditional certificate for the number of shares specified in the certificate assigned.[1]

Article II. Who are such Purchasers.

§ 2603. Who a Bona Fide Purchaser without Notice: Must have Paid the Purchase Money before Notice. — To entitle a

[1] Campbell *v.* American Zylonite Co., 122 N. Y. 455; *s. c.* 11 L. R. A. 596; 34 N. Y. St. Rep. 38; 25 N. E. Rep. 853; reversing *s. c.* 23 Jones & Sp. 562. It has been held in the court of Queen's Bench at Montreal, in a case where it was sought to charge a savings bank with a double liability under a statute as the owner of shares of another bank, that a corporation, shares of which are transferred to a savings bank, is presumed to know that the shares are held by the latter as collateral security, inasmuch as, under the governing statute, a savings bank cannot acquire shares or hold them, except as pledgee. Exchange Bank *v.* City and District Savings Bank, L. R. 6 Q. B. 96.

party to the character of a *bona fide* purchaser, without notice of a prior right or equity, he must not only have obtained the legal right to the property, but he must have paid the purchase money or some part thereof, or have parted with value on the faith of the purchase, before notice of such prior right or equity. The mere giving of security to pay the purchase money is not sufficient to entitle the purchaser to the protection of the court.[1]

§ **2604. Lis Pendens when not Notice.** — The pendency of an action *in another State* to determine the title to corporate stock is not constructive notice to the purchaser in New York of a defect in the title of his assignor, and does not affect the title acquired by him.[2] Whether a *lis pendens* in the domestic State is a constructive notice, in respect of purchases of corporate shares, seems doubtful; for the common law doctrine of *lis pendens* does not apply to negotiable paper and to the ordinary articles of commerce, sold in the usual way.[3]

§ **2605. Who not an Innocent Purchaser.** — One who *knows* that the person purporting to sell or pledge is acting in fraud of the rights of the real owner, or who has information sufficient to put a reasonable and just man upon such *inquiry* as would discover that such is the fact,— is not an innocent purchaser within the meaning of this rule. Thus, when the purchaser knew that the holder held the certificate in a fiduciary character, he was not protected when he took it to secure a debt growing out of another transaction.[4] So, where the vendor was a boy of only sixteen years of age, it was held that the vendee was not a *bona fide* purchaser.[5] So, where one buys a certificate of corporate

[1] Weaver *v.* Barden, 49 N. Y. 286.

[2] Holbrook *v.* New Jersey Zinc Co., 57 N. Y. 616. That a *lis pendens* can have no *extra*-territorial effect, see Carr *v.* Lewis Coal Co., 96 Mo. 149; *s. c.* 9 Am. St. Rep. 328; affg. *s. c.* 15 Mo. App. 328; Shelton *v.* Johnson, 4 Sneed (Tenn.), 672; *s. c.* 70 Am. Dec. 265, and note 269.

[3] *Ante*, § 2433. As to the extent to which the doctrine of *lis pendens* applies to personal property, see the learned opinion of Bakewell, J., in Carr *v.* Lewis Coal Co., 15 Mo. App. 551; also 14 Am. Dec. 778, note. In Pennsylvania the doctrine is applied to non-negotiable securities. Deaum *v.* Lawson Co., 37 Pa. St. 533. See also Hayemeyer *v.* Superior Court, 84 Cal. 327; *s. c.* 18 Am. St. Rep. 192.

[4] Prall *v.* Tilt, 28 N. J. Eq. 479.

[5] Anderson *v.* Nicholas, 28 N. Y. 600.

stock not under seal of the corporation and not signed by the person whom he knows is its president under a representation that it is all the stock of the company, but with the knowledge that certain persons are officers and directors of the company, and that the articles of incorporation require directors to be stockholders, — these facts are sufficient to put him on inquiry, and he cannot be said to be an innocent purchaser.[1]

§ 2606. **When Purchaser from Corporate Officer Bound to Investigate His Authority.** — One who accepts newly-issued certificates of stock from an officer of a corporation, who has authority from the corporation to sign, seal and issue for the corporation certificates of its stock, as collateral security for a personal loan made to the officer, is bound to inquire whether the officer has authority to issue the certificates for the purpose intended; and if he does not make such inquiry, and the officer in fact issues them in fraud of the rights of the corporation, he takes them subject to those rights. The officer in question was the treasurer of a railroad company, and the principle of the decision was that one dealing with an agent in a matter affecting his principal, and knowing that the interest of the agent is adverse to that of his principal, should be held to the duty of ascertaining that the acts of the agent are authorized by his principal.[2]

§ 2607. **Who not a Purchaser for Value.** — The rule in respect of purchases of *land* is that no one is a purchaser for *value* until he has paid money or other thing of value, and then only in respect of the money or value paid. In respect of

[1] Byers *v.* Rollins, 13 Colo. 22; *s. c.* 21 Pac. Rep. 894.

[2] Farrington *v.* South Boston R. Co., 150 Mass. 406; *s. c.* 15 Am. St. Rep. 222; 5 L. R. A. 849; 7 Rail. & Corp. L. J. 196; 23 N. E. Rep. 109. This case is distinguished from Allen *v.* South Boston R. Co., 150 Mass. 200, *s. c.* 15 Am. St. Rep. 185 in which the plaintiff was a purchaser of stock fraudulently issued by the treasurer of the same corporation, and where the corporation was held liable for his fraudulent acts, and where it was held that the purchaser of corporate shares does not assume any duty towards the corporation to see that the vendor of stock surrenders the stock and transfers it on the books of the corporation, that being the duty of the corporation towards both the buyer and seller before it issues new certificates.

assignments of commercial paper, bills of lading, etc., there is a difference of opinion whether, in order to make one a purchaser for value within the meaning of the rule which cuts off equities, he must have parted with new value at the time of the transfer, or whether he occupies the same advantage where he takes by way of security for an antecedent indebtedness.[1] The road is open for the same difference of opinion in respect of sales of corporate stocks, though no reason is perceived why there should be one rule in this respect in respect of land and another in respect of personal property. But it has been held that, although there has been a negotiation for a sale, yet if a creditor of the intending vendor attaches before the purchase price is paid and the certificates delivered, the rights of the attaching creditor are superior to those of the vendee.[2] And more broadly and in analogy to the rule in respect of land, and it may be added on the soundest grounds, it has been held that one is a holder for value within the meaning of the rule only in so far as he parts with value at the time of the transaction; he is not a purchaser for value to the extent of an overdue check surrendered and an antecedent debt receipted for.[3]

§ 2608. Notice to Purchaser from Officer Acting as His Agent. — The mere fact that the officer of the corporation who makes fraudulent issue of its shares to purchaser is acting as broker for the purchaser at the time, does not impute to the purchaser constructive notice of the fraudulent character of his act, — the principle being that notice to an agent is not imputed to his principal when the agent is engaged in committing an independent fraudulent act on his own account, and when the facts to be imputed relate to this fraudulent act.[4] This is merely an application of the general doctrine in the law of agency, that the acts of an authorized officer of a corporation are binding upon the corporation, and that when he is acting within the apparent scope of his authority, one dealing with him is not bound to have

[1] See Conrad *v.* Fisher, 37 Mo. App. 352.

[2] Young *v.* South Tredegar Iron Co., 85 Tenn. 189; *s. c.* 4 Am. St. Rep. 752.

[3] Moodie *v.* Seventh National Bank, 11 Phila. (Pa.) 366.

[4] Allen *v.* South Boston R. Co., 150 Mass. 200; *s. c.* 15 Am. St. Rep. 185.

knowledge of extrinsic facts making it improper for him to act in the particular case.[1]

§ 2609. Notice of Broker's Want of Authority Implied from Failure to Execute Blank Power of Attorney. — If the principal delivers certificates to the broker without executing the usual blank power of attorney indorsed thereon, this fact will put any one with whom the broker may seek to negotiate the shares, upon inquiry as to the extent of his authority. Accordingly, it has been held that the conduct of executors in delivering to a broker transfers of stock without filling out blank powers of attorney was consistent either with an intention to sell or pledge the shares, or to have themselves registered as the owners, and therefore did not estop them from setting up their title as against a bank to which he had fraudulently transferred them, for the bank ought to have inquired into the broker's authority.[2]

§ 2610. Circumstances Sufficient to Put a Purchaser on Inquiry.— By a provision in the charter of a bank in Vermont, no transfer of stock in the bank was to be valid unless recorded in a book to be kept by the bank for that purpose, and unless the person making the same should have previously discharged all debts due from him to the bank. In October, 1835, one A., who was the owner of nearly 200 shares of the capital stock of the bank, and who was not then indebted to the bank, transferred his stock, in due form, upon the books of the bank, to forty-five different persons, without consideration, and for the purpose of increasing the vote upon his stock at an approaching election of bank officers; and by this transfer four shares were conveyed to the plaintiff. Nearly all of these shares, but not those conveyed to the plaintiff, were reconveyed to A. by the persons to whom they had been transferred; and on the 9th of October, 1837, he made a similar distribution of his stock, by transfer in due form upon the books of the bank, for a similar purpose, and at this time transferred to the plaintiff two shares. A. was at this time indebted to the bank to an amount exceeding the value of all the stock owned by him. The plaintiff had no interest in the six shares which stood in his name, until

[1] Credit Co. *v.* Howe Machine Co., 54 Conn. 357, 389; *s. c.* 1 Am. St. Rep. 123.

[2] Colonial Bank *v.* Cady, 15 App. Cas. 267; affirming *s. c. sub nom.* Williams *v.* Colonial Bank, 38 Ch. Div. 388. See *ante*, § 2592.

October 25, 1837, when he purchased them of A., in payment for pre-existing debts. On the 16th of November, 1839, the bank attached these six shares, as the property of A., upon a debt which accrued January 6, 1837, and caused them to be sold on execution, to satisfy said debt, December 19, 1840. From the time the transfers were made upon the bank to the plaintiff, until the time of the attachment, A. controlled these six shares, as well as the others transferred by him as his own property, and he received all the dividends upon them which were paid previous to the attachment; and the plaintiff made no claim upon the bank until 1841, when he demanded the dividends, and one dividend which became due previous to the sale on execution was paid to him, and payment of those which accrued after the sale was refused. It was held that the plaintiff, having suffered A., for so long a period, to treat the shares as his own, was bound to inquire of the bank as to the state of the title, before purchasing, and to give notice to the bank of his having become the beneficial owner, and that his title, as between him and the bank, could only be regarded as accruing from the time such notice was given, and that the bank having attached the shares previous to receiving such notice was entitled to hold their avails, as against the plaintiff.[1] - - - - In an English case, the executors of a registered owner of shares in an American railway company signed, as executors, the transfers on the back of each certificate, without filling up the blanks, in order that the shares might be registered in their own names, and sent them to their broker, who fraudulently deposited the certificates with a bank, which took them *bona fide* and without notice, as security for advances. It was in evidence that, neither on the New York nor on the London Stock Exchanges, are transfers of shares, signed by executors, treated as being "in order," or accepted in commercial circles, as sufficient security for advances, unless accompanied by an extract from the probate and an attestation of the genuineness of the executor's signatures by a consul or other competent officer. The House of Lords held that, although such execution of the power of attorney in blank was sufficient to authorize the transfer of the shares, yet, in view of such commercial usage, the bank, taking them without such attestation of the executors' signatures, was charged with a duty to inquire into the broker's authority, and that the executors were not estopped from setting up their title as against the bank.[2]

[1] Sabin *v.* Bank of Woodstock, 21 Vt. 353.

[2] Colonial Bank *v.* Cady, 15 App. Cas. 267; affirming *s. c.* 38 Ch. Div. 388; and reversing 36 Ch. Div. 659; 2 Rail. & Corp. L. J. 141; 57 L. T. (N. S.) 188.

CHAPTER XXXIX.

PLEDGES AND MORTGAGES OF SHARES.

ARTICLE I. NATURE AND INCIDENTS OF THE CONTRACT.

§ 2615. Nature of a Pledge: Delivery Essential. — The ordinary idea of a pledge is that it is a transfer, delivery or deposit of a chattel for the purpose of securing a debt or some other obligation. The essential idea of a pledge is that it is effected by a *delivery* of the thing pledged; and hence it is often said that delivery is essential to the creation of a valid pledge.[1]

[1] Brewster *v.* Hartley, 37 Cal. 15, 25; *s. c.* 99 Am. Dec. 237, 242; Atkinson *v.* Foster, 134 Ill. 473; Vanstone *v.* Goodwin, 42 Mo. App. 39; Casey *v.* Cavaroc, 96 U. S. 467; Casey *v.* Schneider, *Id.* 496; Association *v.* Wiltz, 10 Fed. Rep. 330. See also Caffin *v.* Kirwan, 7 La. An. 221. That shares of stock may be pledged by contract and simple delivery of the

Shares of corporate stock are incorporeal *choses in action*. The certificate is not the stock, but is only the shareholder's muniment of title. It is, therefore, strictly true that shares of corporate stock may be pledged, although incapable of actual delivery.[1] There is no *actual*, though there is always a *symbolical* delivery—the certificate of the share or collection of shares, and this is always delivered in case of a pledge of corporate stock. Delivery of the symbol being essential to the pledge, it follows that shares of stock cannot be pledged, unless they are evidenced by certificates, which must be transferred and delivered to the pledgee. If, therefore, there are no certificates, there can be no pledge.[2]

§ 2616. Distinction between a Pledge and a Mortgage of Shares.— The substantial distinction between a pledge and a mortgage seems to be that in the case of a pledge, the thing itself must pass by a delivery, either actual or symbolical, while at the same time the legal title does not pass; whereas, in the case of a mortgage the legal title does pass, while the thing mortgaged may remain in the possession of the mortgagor.[3] Speaking with reference to this question, it was said by Chapman, J.: "The ordinary distinction between a mortgage and a pledge is, that by the former the general property passes, while by the latter it does not, but merely a special property passes."[4] It is also pointed out that a pledge is more in the nature of a *trust* than is a mortgage. "The principal reason assigned for not regarding a mortgage as strictly a trust is, that the mortgagee

certificates, see Blouin *v.* Hart, 30 La. An. 714; Factors' &c. Ins. Co. *v.* Marine &c. Co., 31 La. An. 149.

[1] Re Wiley, 4 Biss. (U. S.) 172, where the doctrine of the text is recognized, though the thing pledged was a *note*.

[2] Lallande *v.* Ingram, 19 La. An. 364; Bidstrup *v.* Thompson, 45 Fed. Rep. 452.

[3] See Dewey *v.* Bowman, 8 Cal. 145, 151; Doak *v.* Bank, 6 Ired. Law (N. C.) 309; Vanstone *v.* Goodwin, 42 Mo. App. 39. The modern theory of a pledge was understood in the times of Coggs *v.* Bernard, 2 Ld. Raym. 909, where it is said that the fourth sort of *bailments* is where goods or chattels are delivered to another as a pawn to be a security to him for money borrowed of him by the bailor. Of course, where the legal title passes it can not be called a bailment. On the other hand, where the legal title does not pass the instrument will not be allowed to operate as a mortgage. Vanstone *v.* Goodwin, *supra*.

[4] Newton *v.* Fay, 10 Allen (Mass.), 505, 506.

has a property in the thing which he may make absolute in case the condition is not performed, by foreclosing the right of redemption. But the pledgee can not do this. If the debt or duty is not discharged, he must avail himself of the security by selling the thing pledged, and not by foreclosure; and he holds the avails of the sale in trust to discharge the debt or duty, and, if any balance remains, to pay it to the pledgor."[1] Moreover, if the debt, to secure the payment of which the pledge is made, be not discharged when due, the pledgee does not for that reason obtain an absolute title to the pledge; but he then acquires *the right to sell it* and to pay himself out of the proceeds of the sale. If such proceeds are not sufficient to discharge the debt entire, the pledgor remains liable for the deficiency; if they are more than sufficient, the pledgee is responsible for the surplus.[2]

§ 2617. Mortgage of Shares with Possession Retained by Mortgagor. — Shares of corporate stock are personal property; and, at common law, personal property could not only be mortgaged, but mortgages of such property were in many cases valid, without change of possession, in the absence of fraud, even against subsequent *bona fide* purchasers and creditors.[3] In

[1] *Ibid.* 507.

[2] Dewey *v.* Bowman, 3 Cal. 145, 151.

[3] Holbrook *v.* Baker, 5 Me. 309; *s. c.* 17 Am. Dec. 236; Bissell *v.* Hopkins, 3 Cow. (N. Y.) 166; *s. c.* 15 Am. Dec. 259; Bucklin *v.* Thompson, 1 J. J. Marsh. (Ky.) 223; Letcher *v.* Norton, 5 Ill. 575; Homes *v.* Crane, 2 Pick. (Mass.) 607, 610. In the absence of governing statutes, the general rule is that the retention of possession by the mortgagor of chattels is *prima facie* though not conclusive evidence of fraud: it does not make the mortgage void even as to third parties, provided it is explained to the satisfaction of a chancellor or of a jury, consistently with honest intentions. Kidd *v.* Rawlinson, 2 Bos. & P. 59; Latimer *v.* Batson, 4 Barn. & C. 652; Bryant *v.* Kelton, 1 Texas, 415, 429; Gibson *v.* Hill, 21 Texas, 225; Thompson *v.* Blanchard, 4 N. Y. 303, 306; Foster *v.* Woodfin, 11 Ired. L. (N. C.) 339; Beals *v.* Guernsey, 8 Johns. (N. Y.) 446; Craig *v.* Ward, 9 Johns. (N. Y.) 197, 201; Farrington *v.* Caswell, 15 Johns. (N. Y.) 430; Dickenson *v.* Cook, 17 Johns. (N. Y.) 332; Parker *v.* Parker, 2 Metc. (Mass.) 423, 432; Bissell *v.* Hopkins, 3 Cow. (N. Y.) 166, 186; *s. c.* 15 Am. Dec. 259; Briggs *v.* Parkman, 2 Metc. (Mass.) 258; *s. c.* 37 Am. Dec. 89; Cadogan *v.* Kennett, Cowp. 432, 435; Brooks *v.* Powers, 15 Mass. 244; *s. c.* 8 Am. Dec. 99; Benton *v.* Thornhill, 7 Taunt. 149; Runyon *v.* Groshon, 12 N. J. Eq. 86; Badlam *v.* Tucker, 1 Pick. (Mass.) 389; *s. c.* 11 Am. Dec. 202; Miller *v.* Shreve, 29 N. J. L. 250; Brown *v.* Riley, 22 Ill. 45, 52; Neece *v.* Haley, 23 Ill. 416. See also Askew *v.* Rey-

the case of a mortgage, the question of *delivery*, as between the parties, saving always the rights of creditors and subsequent purchasers, is *immaterial*. If the mortgage is foreclosed and the stock sold, the purchaser may maintain an action against the corporation to compel the issue of a certificate to himself; and to such action, the mortgagor is not a *necessary party*.[1] On the other hand, a pledge by an instrument in writing (or, in Louisiana, by a *notarial act*), not accompanied by a delivery of the certificate, is no pledge as against *third persons*, and notwithstanding such an attempted pledge, is not good as against a *judgment creditor* of the pledgor.[2]

§ **2618. Illustrations of Pledges of Shares.** — The kind of agreement, familiar to all bankers and business men, whereby the maker of notes delivers certificates of stock as collateral security for the payment of the notes, stipulating that if the notes are not paid at maturity the securities shall be under the control of the holder, who is authorized to dispose of them and apply the proceeds to the credit of the maker, — is therefore a pledge of the stocks, and not a mortgage.[3] So, where share certificates are delivered as a *margin* or *additional security*, to a broker who is carrying other shares for the depositor, the transaction is in law a pledge; and the fact that the depositor has executed the usual blank power of attorney, authorizing the transfer of the scrip, does not change the character of the transaction, but is regarded as merely a necessary act to put the pledge in a condition to be available as such in case of the default of the pledgor.[4]

nolds, 1 Dev. & Bat. (N. C.) 367; Gregory *v.* Perkins, 4 Dev. L. (N. C.) 50; Young *v.* Booe, 11 Ired. L. (N. C.) 347; Arundel *v.* Phipps, 10 Ves. Jr. 139, 145. Nature of the presumption under New York statute. Randall *v.* Parker, 3 Sandf. (N. Y.) 69; Allen *v.* Cowan, 28 Barb. (N. Y.) 99; Collins *v.* Brush, 9 Wend. (N. Y.) 198; Doane *v.* Eddy, 16 *Id.* 523; Randall *v.* Cook, 17 *Id.* 53, 56. There still remains an unfortunate conflict of authority on the question whether retention is *prima facie* or *conclusive* evidence of fraud. 2 Thomp. Tr., §§ 2009, 2010. Notes to Twyne's Case, 1 Sm. Lead. Cas. 1. But the great tendency and weight of authority seem to be that such retention is *prima facie* evidence of fraud merely, unless a different rule is created by statute.

[1] Tregear *v.* Etiwanda Water Co., 76 Cal. 537; *s. c.* 9 Am. St. Rep. 245; 21 Am. & Eng. Corp. Cas. 489; 18 Pac. Rep. 658; 4 Rail. &. Corp. L. J. 345.

[2] Bidstrup *v.* Thompson, 45 Fed. Rep. 452.

[3] Brownell *v.* Hawkins, 4 Barb. (N. Y.) 491; Lewis *v.* Graham, 4 Abb. Pr. (N. Y.) 106.

[4] McNeil *v* Tenth Nat. Bank, 55 Barb. (N. Y.) 59.

§ **2619. Title how Vested after a Pledge.** — It is quite obvious, on a little reflection, that it is equally within the power of the pledgor to transfer to his pledgee his *legal title* to secure the debt, retaining only the equity of redemption, so to speak; or retaining his legal title to transfer a special property, sometimes (and perhaps incorrectly) called an equitable title to his pledgee; just as the owner of land may, by an absolute deed, transfer the legal title to secure a debt, retaining an *equitable title*, or the right, by a proceeding in equity, to have the deed declared a mortgage, in other words, to be allowed to redeem; or, on the other hand, just as he may at common law create a valid lien by delivery or deposit of title deeds as security for money. It is hence often said that, as between the pledgor and pledgee of corporate stock, the general property remains in the pledgor, and the pledgee has a special property in the pledge during the continuance of the contract of pledge.[1] Until the debt matures,

[1] Garlick *v.* James, 12 Johns. (N. Y.) 146; *s. c.* 7 Am. Dec. 294 (case of pledge of a note); Brewster *v.* Hartley, 37 Cal. 15; *s. c.* 99 Am. Dec. 237; Wilson *v.* Little, 2 N. Y. 443; *s. c.* 51 Am. Dec. 307; Dewey *v.* Bowman, 8 Cal. 145; Cross *v.* Eureka Lake &c. Canal Co., 73 Cal. 302; *s. c.* 2 Am. St. Rep. 808; 14 Pac. Rep. 885. A pledge of personal property passes to the pledgee merely the possession, with the right of *retainer* until the debt is paid, or other engagement is fulfilled for which the thing pledged is given as security. Luckett *v.* Townsend, 3 Tex. 119; *s. c.* 49 Am. Dec. 723. See Story Bailm. § 286; Doak *v.* Bank, 6 Ired. L. (N. C.) 309. See Cortelyou *v.* Lansing, 2 Caines Cas. (N. Y.) 200, where much of the learning on the subject of pledges is collected by Kent, J. But we shall see that a pledge of corporate shares passes a much larger right than a mere right of retainer: it passes a power of sale. *Post*, § 2659. The California Civil Code defines the contract as "a deposit of personal property by way of security for the performance of another act." Cal. Civ. Code, § 2986. This definition is more accurate than that usually given; for a pledge may be made to secure any lawful engagement as well as the payment of a simple debt. Isaac *v.* Clark, 2 Bulstr. 306. The nature of a pledge is succinctly discussed with citations of numerous authorities in a note in 49 Am. Dec. 730, *et seq.* A pledge differs from a common law mortgage of chattels in this. At common law in a case of a mortgage, an absolute right of property vests in the mortgagee after condition broken, without the intervention of any legal proceedings; but in the case of a pledge the legal title remains in the pledgor, even after a failure on his part to perform the obligation. The possession only passes to the pledgor, coupled with a qualified power of disposition. Ryall *v.* Rolle, 1 Atk. 167; Jones *v.* Smith, 2 Ves. 378; Lickbarrow *v.* Mason, 6 East, 25; Sims *v.* Canfield, 2 Ala. 555; Cortelyou *v.* Lansing, 2 Cai. Cas. 200; Barrow *v.* Paxton, 5 Johns. (N. Y.) 258; *s. c.* 4 Am. Dec.

the pledgee has merely a possessory *lien* upon the shares; and when the debt to secure which they were pledged to him is extinguished the lien is also extinguished.[1] It is said that it is not invariably true that where personal things are pledged for the payment of a debt, the *general property or legal title* always remains in the pledgor, and that in all cases where the legal title is transferred to the creditor, the transaction is a *mortgage*, and not a pledge. While it is true that possession must uniformly accompany a pledge, yet it is true that incorporeal things, like debts, money in stocks, etc., which cannot be manually delivered may be the proper subjects of a pledge. Continuing the discussion of this subject it was said by Ruggles, J.: "There seems to be no reason why any legal or equitable interest whatever in personal property may not be pledged; provided the interest can be put, by actual delivery or by written transfer, into the hands or within the power of the pledgee, so as to be made available to him for the satisfaction of the debt. Goods at sea may be passed in pledge by a transfer of the muniments of title, as by a written assignment of the bill of lading. This is equivalent to actual possession, because it is a delivery of the means of obtaining possession. And debts and choses in action are capable, by means of a written assignment, of being conveyed in pledge. The capital stock of a corporate company is not capable of manual delivery. The scrip or certificate may be delivered, but that of itself does not carry with it the stockholder's interest in the corporate funds; nor does it necessarily put that interest under the control of the pledgee. * * * The general property which the pledgor is said usually to retain is nothing more than the legal right to the restoration of the thing pledged on payment of the debt."[2]

354; Brown *v.* Bement, 8 Johns. (N. Y.) 97; McLean *v.* Walker, 10 *Id.* 471; Eastman *v.* Avery, 23 Me. 248; Day *v.* Swift, 48 *Id.* 368; Gleason *v.* Drew, 9 Greenl. 82; Haven *v.* Low, 2 N. H. 13; *s. c.* 9 Am. Dec. 25; Ash *v.* Savage, 5 N. H. 545; Lewis *v.* Stevenson, 2 Hall (N. Y.) 63; Homes *v.* Crane, 2 Pick. (Mass.) 610; Ward *v.* Sumner, 5 *Id.* 60; Bonsee *v.* Amee, 8 *Id.* 236; Portland Bank *v.* Stubbs, 6 Mass. 425; *s. c.* 4 Am. Dec. 451; Tucker *v.* Buffington, 15 Mass. 480; Fletcher *v.* Howard, 2 Vt. 115; Gay *v.* Moss, 35 Cal. 125; Conard *v.* Atlantic Ins. Co., 1 Pet. (U. S.) 449.

[1] Cross *v.* Eureka &c. Canal Co., 73 Cal. 302; *s. c.* 2 Am. St. Rep. 808. See Brewster *v.* Hartley, 37 Cal. 15, 25; *s. c.* 99 Am. Dec. 237.

[2] Wilson *v.* Little, 2 N. Y. 443, 447, 444; *s. c.* 51 Am. Dec. 307.

§ 2620. Sense in Which an Equitable Title Passes to the Pledgee.—It is frequently said that a *special property* in the pledge passes to the pledgee.[1] It is said in a modern case, speaking with reference to a delivery of certificates of stock in pledge, that such an assignment passes an *equitable title* merely, as between the parties to the transaction. The language of the court is: "By the assignment and delivery of the certificates to the bank [the pledgee] it became, *in equity*, the owner of the stock. As between the parties to the transaction, the title effectually passed, for assignment on the books could be enforced; *but it was an equitable title only*."[2] But this seems to be an inaccurate use of language in describing the title of a pledgee. He has not even an equitable title to the property prior to the maturity of the debt, but he has that species of special property which consists of the right of possession and of sale, upon demand and notice to the pledgor, in case the debt is not paid at maturity. This cannot be called an equitable title, because it is not necessary for the pledgee to go into a court of equity to perfect it into a legal title. But if the pledgee receives the share certificate with an absolute power of attorney and blank assignment indorsed thereon, and the pledgee *re-pledges the shares* to an innocent party without notice of the rights of the original holder, this sub-pledgee may be regarded as acquiring an equitable title to the shares, as a security for the money loaned by him, of which he can not be divested by the original owner. His title is called an equitable title, because it will be *negatively* protected by a court of equity by withholding its usual remedy from the original assignor.[3] The courts have dropped into this inaccuracy of expression, by adopting the analogy of an expression employed to designate the title of the unregistered transferee where the transfer is intended to be absolute between the parties. In such cases it is reasoned that, corporate shares being similar to choses in action, an equitable title passes without observing the requirements of the charter or by-laws, that there shall be a registration of the transfer on

[1] Doak *v.* Bank, 6 Ired. Law (N. C. 309.

[2] Noble *v.* Turner, 69 Md. 519, 524; *s. c.* 16 Atl. Rep. 124.

[3] Otis *v.* Gardner, 105 Ill. 436.

the books.[1] But it must remain true that in a strict sense, in the case of a mere pledge of corporate shares, no *title* passes to the pledgee, either legal or equitable.

§ 2621. Notice to the Corporation not Necessary to a Valid Pledge. — Neither a notice to the corporation nor a transfer on its books is essential to the creation of a pledge of corporate stock, valid as between the pledgor and pledgee.[2] Nor is it material that the corporate charter provides that transfers shall be made only on the books, as this provision should not be construed to include transfers in pledge;[3] and this although the charter provides that no sale or transfer shall be made without sixty days' notice, with privilege to the corporation or its members to purchase on equal terms.[4]

§ 2622. Pledge of Corporate Stock must be in Writing. — "A delivery to the pledgee of the thing pledged is essential to the contract; and until that act is performed, the special property that the bailee is entitled to hold does not vest in him. In respect to most kinds of property, a delivery of the property to the pledgee, without any written transfer of the title, is sufficient to pass the requisite special property. Incorporeal property, being incapable of manual delivery, can not be pledged without a written transfer of the title. Debts, negotiable instruments, stocks in incorporated companies, and choses in action generally, are pledged in that mode. Such transfer of the title performs the same office that the delivery of possession does in case of a pledge of corporeal property. The transfer of the title, like the delivery of possession, constitutes the evidence of the pledgee's right of property in the thing pledged. The transfer in writing of shares of stock not only does not prove that the transaction is not a pledge, but the stock, unless it is expressly made

[1] Laing *v.* Burley, 101 Ill. 591; Kellog *v.* Stockwell, 75 Ill. 68.

[2] Smith *v.* Crescent City &c. Slaughter House Co., 30 La. An. 1378; Friedlander *v.* Slaughter House Co., 31 La. An. 523; Factors Ins. Co *v.* Marine Dock Co., 31 La. An. 149. Pilot *v.* Johnson, 33 La. An. 1286.

[3] Crescent City Seltz &c. Water Man. Co. *v.* Deblieux, 40 La. An. 155; *s. c.* 3 South Rep. 726; Blouin *v.* Hart, 30 La. An. 714.

[4] Crescent City Seltz. & Mineral Water Mfg. Co. *v.* Deblieux, *supra.*

assignable by the delivery of the certificates, can not be pledged in any other manner." [1]

§ 2623. Absolute Transfer may be Shown by Parol to be a Pledge. — Although the transfer is absolute and there is no written contract of pledge, the pledgor may show, on a bill in equity to *redeem*, that the delivery was intended as a pledge to secure a debt and not as an absolute transfer of title to the shares.[2] This conclusion results more easily than the same rule in respect of mortgages, when it is considered that a pledge involves a *trust* on the part of the pledgee much more nearly than a mortgage does; and it has always been the rule of equity, both before and since the statute of frauds, that a trust in personal chattels may not only be created, but established and proved by merely parol declarations.[3] But, of course, the pledgor can not show this as against *third persons*, whose rights have attached *without notice* of the real character of the transaction.

§ 2624. Incidental Rights of the Pledgee. — A pledgee of shares has no right of *action at law against the directors* of the corporation to recover any *damages* which he may have sustained by reason of their *negligence* and *mismanagement* in wasting the assets of the corporation and rendering the shares valueless.[4] This is clear enough, because an ordinary stockholder has no such right.[5] The theory of the law is that the wrong is done to the corporation, and hence where a receiver has been appointed the right of action is in him, as its representative, and not in the

[1] Brewster *v.* Hartley, 37 Cal. 15, 25; *s. c.* 99 Am. Dec. 237, 242. See also Wilson *v.* Little, 2 N. Y. 443; *s. c.* 51 Am. Dec. 307; Jewett *v.* Warren, 12 Mass. 300; *s. c.* 7 Am. Dec. 74; Bowman *v.* Wood, 15 Mass. 534; Dewey *v.* Bowman, 8 Cal. 145. The following cases treat of the nature of pledges of certificates of corporate stock: Hasbrouck *v.* Vandervoort, 4 Sandf. (N. Y.) 74; Fisher *v.* Brown, 104 Mass. 259; *s. c.* 6 Am. Rep. 235; Thompson *v.* Toland, 48 Cal. 99; Rozet *v.* McClellan, 48 Ill. 345; *s. c.* 95 Am. Dec. 551; Heath *v.* Silverthorn &c. Co., 39 Wis. 147; Worthington *v.* Tormey, 34 Md. 182; Conyngham's Appeal, 57 Pa. St. 474; Van Blarcom *v.* Broadway Bank, 9 Bosw. (N. Y.) 532; Whittaker *v.* Charleston Gas. Co., 16 W. Va. 717.

[2] Newton *v.* Fay, 10 Allen (Mass.), 505.

[3] Kingsman *v.* Kingsman, 2 Vern. 559; Nab *v.* Nab, 10 Mod. 404.

[4] Barnes *v.* Swift (Super. Ct. Cin.), 26 Ohio L. J. 110.

[5] Smith *v.* Hurd, 12 Met. (Mass.) 371; *s. c.* 46 Am. Dec. 690; *post,* §4471.

individual stockholders.[1] And the pledgee of shares does not, of course, stand in a better position in this respect than that occupied by his pledgor. If the shares have been transferred to the pledgee on the books of the corporation, he becomes the legal owner as between the corporation and himself, and has, *prima facie*, the *right to vote* in respect of the shares for directors, which right the pledgor has not. But it is held that *equity* will in a proper case compel him to give the pledgor a *proxy*.[2]

§ 2625. Taking such a Pledge from a Married Woman. — It is reasoned in a case before the late commission of appeals of New York, that as coverture does not prevent the acquisition of property by a married woman, the fact of coverture does not affect the title to stock transferred by her; that where the stock stands in her name the certificate is evidence of its absolute ownership by her; and that, if nothing indicates a trust in favor of another person, one from whom a loan is solicited, upon pledge of the stock as security, is warranted in making the loan upon the assumption of such ownership. He is not bound to inquire and ascertain how she obtained it.[3]

§ 2626. Effect of Pledge upon Lien of Corporation. — If the corporation has a valid *lien* upon the shares, it may be assumed, on the most elementary principles of justice, that no act of the shareholder, done without the privity of the corporation, will divest such lien. While, no doubt, the corporation may *waive* or divest itself of such lien by overt corporate action,[4] yet clearly the act of a subordinate ministerial officer, not a member of the board of directors, such as the assistant secretary, in certifying that the corporation has no such lien, will not have this effect.[5] It is also a sound view that, where the corporation issues certificates stating that the shares are paid up, and without reserving a lien for any unpaid balance on the face of the

[1] Howe *v.* Barney, 45 Fed. Rep. 668.

[2] Re Argus Printing Co. (N. Dak.), 1 N. Dak. 434; *s. c.* 26 Am. St. Rep. 639; 12 L. R. 781; 48 N. W. Rep. 347. See also McDaniels *v.* Manufacturing Co., 22 Vt. 274, 284; Re Barker, 6 Wend. (N. Y.) 509; Ex parte Willcox, 7 Cow. (N. Y.) 402, 410; *s. c.* 17 Am. Dec. 525.

[3] Leitch *v.* Wells, 48 N. Y. 585.

[4] *Ante*, § 2337, *et seq.*

[5] Kenton Ins. Co. *v.* Bowman, 84 Ky. 430.

certificates, it ought to be estopped from asserting a lien against an innocent purchaser or pledgee without notice. But where the certificate itself contains a recital that no transfer shall take place on the books of the corporation until after payment of all indebtedness due to the corporation by the persons in whose name the shares stand on the books of the corporation, then one who takes such a certificate, in pledge or otherwise, holds the shares subject to any lien of the corporation for any indebtedness of the pledgor to the corporation, — and this is so, although no lien is given to the corporation, either by its charter, by statute, or by its by-laws. It is simply the case where two parties create a lien by a compact between themselves, and where third persons having notice of it take subject to it.[1] If the case is one of a banking corporation, the acceptance of such a certificate by the shareholder and a subsequent loan to him by the bank effects a contract which creates an equitable lien on his shares for the amount of the indebtedness.[2] Hence, if there is a delivery of the certificates in pledge, and the pledgee gives no notice to the bank of his rights, and the pledgor afterwards becomes indebted to it, its lien will be superior to the equities of the pledgee.[3]

§ 2627. Construction of Particular Agreements of Pledge.— Where an owner of bank stock directs another to obtain all the money possible thereon, and pay the owner's debts to a bank, and adds, "You may apply any and all balance towards the payment of my indebtedness to you," there is no assignment of stock to the latter, and, after his debt is paid, he cannot maintain an action for dividends due thereon.[4] - - - - S. assigned and delivered to R. a certificate of shares of the capital stock of a corporation as collateral security for the payment of a note, and at the same time executed an irrevocable

[1] Jennings *v.* Bank of California, 79 Cal. 323; *s. c.* 12 Am. St. Rep. 145; 21 Pac. Rep. 852; Vansands *v.* Middlesex Bank, 26 Conn. 144, 145.

[2] *Ibid.* As to the lien of a banking corporation upon the shares of its stockholders, see Waln *v.* Bank of North America, 8 Serg. & R. (Pa.) 89.

[3] Jennings *v.* Bank of California, *supra.* In Louisiana, a pledge of shares of stock in a corporation is valid by the delivery of the certificate, and will not be defeated by the fact that the pledgor afterwards becomes indebted to the corporation, the charter of which prohibits transfers in case of the shareholder being indebted to the company. Shares of stock are not "credits" within the meaning of art. 3158 of the Civil Code of that State. Pitot *v.* Johnson, 33 La. An. 1286.

[4] Ware *v.* Merchant's National Bank, 151 Mass. 445; *s. c.* 24 N. E. Rep. 328.

power of attorney authorizing R. to transfer the shares to his own name on the books of the corporation. At the same time, the parties executed an agreement that, upon default in payment of the note, R. might sell or dispose of the stock upon such terms as he saw fit. Before maturity of the note, R. caused the stock to be transferred to his name upon the books of the corporation. It was held that the assignment and the accompanying agreement should be considered together in fixing the rights of the parties; that R. had no right thereunder to cause such transfer to be made before the note matured, and that his attempted transfer did not divest S. of his right to vote upon the stock.[1]

§ 2628. Illustration of an Instrument held to be Neither a Pledge nor a Mortgage. — The following instrument was held to be neither a pledge nor a mortgage, — not a pledge because there was no delivery of the share certificate; not a mortgage, because it did not purport to convey the legal title to the mortgagee: "To secure the payment of my promissory note of even date herewith, in favor of E. R. Vanstone, for the sum of eighteen hundred dollars, payable twelve months after date, with interest from date, at the rate of ten per cent. per annum, I hereby pledge to said E. R. Vanstone, as collateral security for said note, the following personal property, to-wit: Twenty shares of the capital stock of the First National Bank of Marshall, Missouri, now standing in my name on the books of said bank, and represented by certificate of stock number twelve; and, in case default be made in the payment of said note and interest, I hereby appoint A. S. Van Anglen, as my true and lawful attorney in fact, for me, and in my name to sell said stock without notice at public or private sale, at his option, applying the proceeds to the payment of my said note and interest, and accounting to me for the surplus, if any. And the board of directors of said First National Bank are hereby requested to confirm such sale by cancelling said certificate number twelve, and issuing new certificate to the purchaser thereof." It was therefore held that, the bank having gone into liquidation for the purpose of reorganizing as a State bank, its assets being in the hands of its president and cashier as trustees, — this instrument could not be made the foundation of a suit in equity for the purpose of compelling the treasurer and cashier to pay into court the value of the shares at the time of the dissolution of the bank and the profits arising from the use thereof, etc., nor for any other equitable relief. The opinion is not at all clear or

[1] State *v.* Smith, 15 Oreg. 98; *s. c.* 19 Am. & Eng. Corp. Cas. 496; 14 Pac. Rep. 814; 2 Rail. & Corp. L. J. 398.

satisfactory, and the court concludes by saying: "It would seem that the plaintiff has been badly treated, in consequence of which she has perhaps lost her debt; but while this is so, we are unable, upon the facts presented to us, to suggest any principle in equity which would afford her any relief."[1] The ordinary jurisdiction of equity to enforce liens would seem to suggest an appropriate road to the doing of justice in so plain a case.

§ 2629. Status of the Pledgee where the Debt has been Paid. — Where the debt for which the shares had been pledged has been paid, and the legal title is still allowed to stand in the name of the pledgee, his trust relation is not determined, but he holds the shares in trust for the pledgor, subject to the obligation of returning the same upon the demand of the latter. When, therefore, shares of stock of an incorporated company had been conveyed by the plaintiff to the defendant as collateral security for a debt, and the debt was afterwards paid, but nevertheless the shares continued to stand in the defendant's name, and while so standing, were *assessed* under an act of the legislature, were sold for the non-payment of the assessment, and the defendant became the purchaser, — it was held that the sale was invalid, and that the defendant was liable in *trover* for the value of the shares at the time of the alleged sale, and for the *dividends* he had received thereon, together with *interest*, after deducting the amount of the asessments and expenses of the sale.[2]

ARTICLE II. VALIDITY AS AGAINST THIRD PARTIES.

§ 2633. Assignment in Pledge without Delivery not Good against Creditors without Notice. — The principle that a

[1] Vanstone *v.* Goodwin, 42 Mo. App. 39.

[2] Freeman *v.* Harwood, 49 Me. 195.

pledge, valid as against creditors, can only be created by delivery, has resulted in the holding that where a stockholder, for the purpose of securing his creditor, made an assignment of his shares *by a separate writing*, but never indorsed or transferred the certificates on the books of the company or otherwise, but retained possession of them as before, in which condition they were seized by a receiver appointed under a creditor's bill against him, the receiver having no notice of the attempted assignment, — the receiver could hold the certificates; since the assignment was merely a *secret lien* and passed no title as against the creditors whom the receiver represented. Wilkins, J., said: "That a sale of personal property without delivery is invalid as against subsequent purchasers and creditors, will not be denied. That a pledge of property can only be sustained against such parties when the thing pledged is actually delivered to the pledgee, must be admitted. In fact, a pledge, strictly speaking, can only be made by delivery. The fact that the property is seized through the intervention of a receiver can make no difference as to the rights of a creditor."[1]

§ 2634. Rights of Attaching Creditors of Pledgor. — If, therefore, the shares are not regularly transferred to the pledgee on the books of the corporation, the pledge will not, according to the prevailing opinion,[2] be valid as against subsequent attaching or execution creditors of the pledgor;[3] but such an unrecorded transfer in pledge vests such a title in the pledgee as equity will protect against one attaching the stock in a suit against the pledgor with *knowledge* of facts sufficient to put him on *inquiry* regarding the so-called equitable ownership.[4]

[1] Atkinson *v.* Foster, 134 Ill. 472, 480; *s. c.* 25 N. E. Rep. 528; Bidstrup *v.* Thompson, 45 Fed. Rep. 452.

[2] *Ante*, § 2409.

[3] Fort Madison Lumber Co. *v.* Batavian Bank, 71 Ia. 270; *s. c.* 60 Am. Rep. 789; 32 N. W. Rep. 336; *s. c.* on subsequent appeal, 77 Ia. 393; *s. c.* 42 N. W. Rep. 331; State Ins. Co. *v.* Sax, 2 Tenn. Ch. 507; Noble *v.* Turner, 69 Md. 519; *s. c.* 16 Atl. Rep. 124.

[4] Cheever *v.* Meyer, 52 Vt. 66; Weston *v.* Bear River &c. Co., 6 Cal. 425; *ante*, § 2410. An entry in a stock book of a corporation, that certain stock has been assigned as collateral security, is sufficient to protect the assignee against the claims of judgment creditors of the assignor, under Iowa Code, § 1078, providing that a transfer of corporate stock is not valid as to third persons until regularly entered in the company's books. Moore *v.* Marshalltown &c. Co., 81 Ia. 45: *s. c.* 46 N. W.

§ 2635. Illustration of an Attempted Pledge by a Writing not Good against a Judgment Creditor. — The doctrine of the preceding section is well illustrated by a case in the Circuit Court of the United States for the Eastern District of Louisiana, where an agreement had been entered into between the owner of sixty shares in a manufacturing company and the other shareholders, whereby the sixty shares were deposited with a trustee, not to be taken out of his possession or put upon the market until January 1st, 1891, — the trustee giving to the shareholder the following written obligation: "No. 8. New Orleans, Jan. 9th, 1890. This is to certify that I, W. J. Behan, trustee, hold in my possession, for account of Phillip Thompson, a certificate of stock in the Electric Traction and Manufacturing Company (No. 8) for sixty shares, standing in the said name. This stock is held by me, as trustee aforesaid, under an agreement among certain subscribers to the effect that none of this stock, so held by me as trustee, is to be taken out of my possession or put on the market until after January 1st, 1891. After that date, on the surrender of this certificate, I will deliver the aforesaid certificate of stock to the said Phillip Thompson on his written order. [Signed] W. J. Behan, Trustee." Before the expiration of the time named in this instrument, Thompson procured from a bank a loan of $20,000 and, as security therefor, attempted a pledge of these shares, already deposited with the trustee under the above trust agreement. What he did to effectuate this attempted pledge was this: He delivered to the bank the written obligation above set out, together with a power of attorney in blank, authorizing the transfer of the sixty shares upon the books of the corporation. There was no indorsement or other order from him as to the delivery of the certificate directed to Behan, the trustee, and no notice was given to Behan of the transfer. While the title to the shares was in this situation, a judgment creditor of Thompson levied upon them in the hands of Behan, the trustee, who held the certificate. The bank intervened, and the question was whether the equities of the bank were superior to those of the judgment creditor. The court, in an opinion

Rep. 750. B. and S. were indebted to A. by their joint note. A. calling on them for security, they agreed that they would each transfer to him fifteen shares of certain insurance stock, and that the stock of S., after securing the note, should be held by A. as security to B. for certain liabilities assumed by him for S. B. transferred his fifteen shares to A., and S. went to the insurance office to transfer his, when it was found that all his stock had been *attached* by a creditor. The creditors of S. soon after instituted proceeding in insolvency against him. The attachment being vacated thereby, it was held that B. acquired no lien whatever on the fifteen shares of the stock of S. Shipman *v.* Ætna Ins. Co., 29 Conn. 245.

by Mr. District Judge Billings, held that the equities of the judgment creditor were superior to those of the attempted pledgee. He placed his ruling on Federal and State decisions to the effect that a delivery is essential to the validity of a pledge as against third persons.[1]

§ 2636. Power of Pledgee to Pass Title to Innocent Purchaser.[2] — So, also, a pledgee to whom shares of corporate stock are delivered, with an assignment indorsed in blank and an irrevocable power of transfer signed and sealed by the transferor, may pass a good title thereto to an innocent purchaser, or may pass such an interest therein to an innocent pledgee that the latter may hold them as security for his advances after other securities are exhausted.[3] Such a case is different from the ordinary case where the owner of personal property merely delivers possession of it to a third person. Here he does more than deliver possession. He delivers with the possession a *written evidence of a transfer of title*, without expressing on its face the conditions on which the title is apparently transferred. "The holder of such a certificate and power possesses all the external *indicia* of title to the stock, and an apparently unlimited power of disposition over it. He does not appear to have, as is said in some of the authorities cited, concerning the assignee of a chose in action, a mere equitable interest, which is said to be notice to all persons dealing with him that they take subject to all equities, latent or otherwise, of third parties; but, apparently, the legal title and the means of transferring such title in the most effectual manner. Such, then, being the nature and effect of the documents with which the plaintiff intrusted his brokers, what position does he occupy toward persons who, in reliance upon those documents, have in good faith advanced

[1] Bidstrup *v.* Thompson, 45 Fed. Rep. 452.

[2] See further of this subject, *ante*, § 2587, *et seq.*

[3] McNeil *v.* Tenth Nat. Bank, 46 N. Y. 325; *s. c.* 7 Am. Rep. 341; Thompson *v.* Tolland, 48 Cal. 99, 112. To the same effect is Brewster *v.* Sime, 42 Cal. 139; Cherry *v.* Frost, 7 Lea (Tenn.), 1. In Thompson *v.* Tolland, *supra*, this principle was applied on very doubtful grounds, in a case where the pledgee pledged the shares to secure an *antecedent debt*, and *his* pledgee parted with no *new value*. Such a person ought not to be held an purchaser for value as against the real owner, unless he makes it appear that he lost other means of securing his debt by taking the pledge. Burton *v.* Peterson, 12 Phila. (Pa.) 397.

money to the brokers or their assigns on pledge of the shares? When he asserts his title, and claims as against them, that he could not be deprived of his property without his consent, can not he be truly answered that, by leaving the certificate in the hands of his brokers, accompanied by an instrument bearing his own signature, which purported to be executed for a consideration, and to convey the title away from him, and to empower the bearer of it irrevocably to dispose of the stock, he in fact 'substituted his trust in the honesty of his brokers for the control which the law gave him over his own property,' and that the consequences of a betrayal of that trust should fall upon him who reposed it, rather than upon innocent strangers from whom the brokers were thereby enabled to obtain their money?"[1] It has therefore been held that pledgees of corporate shares, in good faith and without notice that their pledgor is not the absolute owner, are entitled to hold them as security for their entire loan, although it is much greater than the debt of the real owner who pledged the shares to their pledgor, where, although they might have discovered by investigation that he was a stockbroker, besides being engaged in other business, there was nothing in the original or various intermediate transfers before they reached the pledgees to show that he held the shares by way of security in connection with stock speculations.[2] But, as already seen,[3] *under the English law* a holder of shares, although indorsed in blank, cannot transfer a better title to them than that which he himself possesses; although it is admitted that by that law the real owner may estop himself by conduct or representation from questioning the title of the transferee who honestly takes from a dishonest holder.[4] This follows from the

[1] Rapallo, J., in McNeil *v.* Tenth Nat. Bank, 46 N. Y. 325 and 333; *s. c.* 7 Am. Rep. 341, 346. See, further, Jarvis *v.* Rogers, 13 Mass. 105; Jarvis *v.* Rogers, 15 Mass. 369, 389; Commercial Bank *v.* Kortright, 22 Wend. (N. Y.) 348, 362; *s. c.* 34 Am. Dec. 317; Fatman *v.* Lobach, 1 Duer (N. Y.), 354 (with which compare McCready *v.* Rumsey, 6 Duer (N. Y.), 574). Compare Covell *v.* Tradesman's Bank, 1 Paige (N. Y.), 131; Bush *v.* Lathrop, 22 N. Y. 535. Ex parte Swan, 7 C. B. (N. S.) 400; Swan *v.* North British Australasian Co., 7 Hurl. & N. 603; Swan *v.* North British Australasian Co., 2 Hurl & C. 175.

[2] Duggan *v.* London & C. Loan & A. Co., 18 Ont. App. 305; *s. c.* 34 Am. & Eng. Corp. Cas. 641.

[3] *Ante*, § 2591.

[4] Williams *v.* Colonial Bank, 38 Ch. Div. 388, 399.

doctrine which denies the quality of negotiability to share certificates and places them on the footing of other personal property.[1]

§ 2637. Purchasers with Notice Take Subject to Rights of Pledgor. — It is scarcely necessary to say that one who purchases shares of corporate stock, whether at a private or judicial sale,[2] with actual notice,[3] or with a knowledge of such facts as upon reasonable inquiry would enable him to know,[4] that the certificates have been pledged, takes subject to the rights of the pledgee and gets only such title as the pledgee had.

§ 2638. What Imports Notice: Addition of the Word "Trustee." — Where the owner of stock delivers the certificate to his pledgee, with a power to transfer it, the fact that his name is in the certificate is not notice of his rights, as against third persons who take it for value from the pledgee.[5] But, by analogy to the rule elsewhere pointed out,[6] if the certificate shows on its face that it is issued "*in trust*" to the person who attempts to pledge it, this is sufficient to put the pledgee upon inquiry and to charge him with notice of the trust, and of all that he might have ascertained by inquiry; and if he pledges it in breach of his trust, the pledgee must account to the *cestui que trust*, or to the substituted trustee, for the amount misappropriated by the pledgor.[7] Thus, where the holder of shares transferred them to his brokers in trust to secure a loan, and the brokers again transferred them to secure a larger loan made to themselves, and there were several successive transfers "in trust," — it was held that the original owner had the right to redeem them from the last transferee, by paying the amount of his indebtedness to his immediate transferees; because the words "in trust," ex-

[1] That such is the English law in regard to personal property generally, see Cole *v.* Northwestern Bank, L. R. 10 C. P. 354, 362.

[2] *E. g.*, at a sheriff's sale: Weston *v.* Bear River &c. Co., 6 Cal. 425.

[3] *Ibid.*

[4] Cheever *v.* Meyer, 52 Vt. 66.

[5] Felt *v.* Heye, 23 How. Pr. (N. Y.) 359.

[6] *Ante*, § 2537.

[7] Duncan *v.* Jaudon, 15 Wall. (U. S.) 165; Budd *v.* Monroe, 18 Hun (N. Y.), 316; Gaston *v.* American Exch. Nat. Bank, 29 N. J. Eq. 98; Duggan *v.* London &c. Co., 19 Ont. 272, 278.

pressed after the name of the holder in the share certificate, put them upon *inquiry* as to the title of their transferor.[1]

§ **2639. Lis Pendens.** — Stocks are articles of commerce, passing from hand to hand, like commercial paper ; and it has been said that the doctrine of a constructive notice by *lis pendens* is not applicable to them.[2]

Article III. Returning the Identical Certificate.

§ **2642. A Right to Shares is not a Right to Certificates of a Particular Number.** — It is well said that "certificates of stock are not *securities* for money in any sense ; much less are they negotiable securities. They are simply the muniments and evidence of the holder's title to a given share in the property and franchises of a corporation in which he is a member.[3] This being so, where the shares in a corporation are equal in denomination and none of them in any respect preferred before the others, the right of a subscriber to have a given number of

[1] Duggan *v.* London &c. Co., 19 Ont. 272.

[2] Leitch *v.* Wells, 48 N. Y. 586, 609, per Earl, C.

[3] Accordingly, it has been held that subsequent cancellations and issues of new certificates of stock do not work any change in the stock itself. "The stock remained the same from first to last. Stock is one thing and certificates another. The former is the substance and the latter is the evidence of it." Hawley *v.* Brumagim, 33 Cal. 394, 399, opinion by Sanderson, J.

shares may broadly be said to be, not a right to have certificates of any particular numbers in the series. His rights are satisfied if there be allotted to him the number of shares of stock for which he has subscribed; for when he is the holder of certificates numbered from 1 to 10 he holds precisely the same proprietary interest in the company as when he holds certificates numbered from 91 to 100. It has been held in several cases, that where a bailee holds corporate stock in his own name, or in the name of a third person in trust for his bailor, he is not bound to ear-mark or identify the particular certificates and have them forthcoming under the terms of the trust agreement, but it is sufficient if he keep at all times on hand a sufficient number of shares of the company of the same series and kind to return to his bailor when lawfully called upon so to do.[1]

§ 2643. Pledgee or Trustee not Bound to Hold the Identical Certificates.— And if shares of stock have been pledged as collateral to secure the payment of a promissory note, it will be *sufficient if the pledgee have on hand the same number of the same series of the shares of the same company, at the time the note falls due;* and if he sell these in pursuance of the contract of pledge, he will discharge the contract on his part, and will not be liable to account to his bailor for the highest price at which similar shares were sold by him, the bailee, at any time during the period.[2] Under this theory the pledgee may, by delivering

[1] Nourse *v.* Prime, 4 Johns. Ch. (N. Y.) 490; *s. c.* 8 Am. Dec. 606; 7 Johns. Ch. (N. Y.) 69, 87; *s. c.* 11 Am. Dec. 403; LeCroy *v.* Eastman, 10 Mod. 499; Horton *v.* Morgan, 6 Duer (N. Y.), 56; *s. c.* affirmed, 19 N. Y. 170; 75 Am.Dec. 311; Gilpin *v.* Howell, 5 Pa. St. 41; *s. c.* 45 Am. Dec. 720; Allen *v.* Dykers, 3 Hill (N. Y.), 593. And on the reasoning already stated, it was adjudged by the Supreme Court of California that there is in this respect no difference in principle between the case where the bailee holds the stock in his own name, and where he holds it in the name of his bailor; in either case the right of the bailor is not to certificates having particular numbers in the series, but to a given number of shares, and if he gets this he sustains no injury and has no right of action against his bailee. Hawley *v.* Brumagim, 33 Cal. 394.

[2] Nourse *v.* Prime, 4 Johns. Ch. (N. Y.) 490; *s. c.* 8 Am. Dec. 606; 7 Johns. Ch. 69; 11 Am. Dec. 403; Atkins *v.* Gamble, 42 Cal. 86, 106; *s. c.* 10 Am. Rep. 282; Berlin *v.* Eddy, 33 Mo. 426, 430. In this last case Bates, J., answered the objection that the bailee had committed a wrong upon

to the pledgor *other certificates* of shares in the same company, being in all respects of the same series and equal in value to those which were the subject of the pledge,— exonerate himself from more than *nominal damages* for the conversion of the certificates actually received in pledge. The reason of the rule was aptly stated by Mr. Justice Crockett: "The general rule is, as we have stated, that the owner of personal property which has been wrongfully converted is entitled to recover his specific property or its value, and cannot be compelled to accept other property of the same kind and of equal value, in lieu of that which was converted. The reason of the rule is obvious. The owner may have special reasons for desiring to retain that specific chattel; and there may be reasons why he attached a peculiar value to it beyond the value of other chattels of a precisely similar kind. If his desire in this respect be the result of mere caprice, he is entitled to be gratified in the exercise of it. Visible, tangible chattels may have secret defects which no vigilance could detect. If two visible objects be precisely similar, one may have infirmities not discoverable on inspection, which would impair or destroy its value. Hence, the owner of such chattel cannot be compelled to accept in lieu of it another which appears to be precisely similar and of equal value. He cannot be required to take the risk of secret defects in the substituted article. Other considerations also affect the general rule. If a favorite horse, a pet dog, or a family picture be converted by a wrong-doer, he could not escape responsibility by offering another horse, dog or picture, even of greater value. But we think the reason of the rule ceases when applied to stocks. It is impossible that any sane person should have centered his affections upon a particular stock certificate, or that any violence could be done to his feelings by requiring him to accept another certificate of precisely similar character, in lieu of it. His own certificate was only the

the bailor by mingling the certificates of stock with other certificates of the same stock belonging to himself or to other persons, by saying: "The shares of the stock in question do not appear to have been in any way distinguished or distinguishable from any other similar number of shares of the same stock; all were of equal worth and worthlessness, and the sale of one batch answered the purpose as well as another." As to the extent to which this rule is applicable where shares are held by a *trustee*, see Pinkett *v.* Wright, 2 Hare, 120.

evidence that he owned an undivided interest in the capital and business of the corporation. Another certificate of the same kind, for the same amount of stock, would entitle him to precisely the same rights as the former certificate. Each would be a precise equivalent of the other, and it is certain he could suffer no pecuniary loss by the transaction; whilst the nature of the property, or rather of his interest in it, forbids the idea that it could be the object of personal attachment, or have a peculiar value in his estimation, as contradistinguished from any other equal number of shares in the same company. For these reasons, we think a different rule should govern the conversion of a certificate of stock; and if the wrong-doer was at all times ready and willing to transfer to the owner an equivalent number of similar shares in the same company, by a proper and valid certificate, it would present a case for nominal damages only." [1]

§ **2644. Further of this Subject.**—It is true, as a general rule, that where the pledge is distinctive in its character, and therefore capable of being recognized among other things of like nature, or where a mark is set upon it with a view to its discrimination, the pledgee is bound to re-deliver the identical article pledged, and can not substitute something of like kind and value, unless so authorized by the contract of pledge.[2] But this rule is said to have no application where the thing pledged, from its very nature, is incapable, in itself, of identification, if once mingled with other things of the same kind. In such a case it is reasoned that "it is not the duty of the pledgee to put a mark upon it by which he may distinguish it.[3] For if a person will suffer his property to get into a common mass without making some provision for its identification, he has no right to ask more than that the quantity he put in should always be there and ready for him. By a just fiction of law, that *residuum*

[1] Atkins *v.* Gamble, 42 Cal. 86, 100; *s. c.* 10 Am. Rep. 282, 291.

[2] Gilpin *v.* Howell, 5 Pa. St. 41, 57; *s. c.* 45 Am. Dec. 720, 727.

[3] As is said in Nourse *v.* Prime, 4 Johns. Ch. (N. Y.) 490; *s. c.* 8 Am. Dec. 606. These observations were repeated by Chancellor Kent in Nourse *v.* Prime, as reported in 7 Johns. Ch. (N. Y) 69; *s. c.* 11 Am. Dec. 403, and were noticed with approbation by Nelson, C. J., in Allen *v.* Dykers, 3 Hill (N. Y.) 593.

shall be presumed to be the portion he put in."[1] These observations were made with reference to pledges of shares of capital stock, which were not specially marked so as to identify them from other shares of the like denominations of the same corporation; and in such a case the just conclusion has been reached that the broker is not bound to keep on hand the identical certificates and re-deliver them, but that it will be sufficient if, at the expiration of the term of pledge, he re-delivers an equivalent number of the like shares.[2] Nor is the identity of the pledge changed by the act of the pledgee in surrendering the certificates which have been delivered and taking out new ones in his own name.[3]

§ 2645. Illustration: Pledgee Returning Similar Shares, though not the Identical Certificate.— In a leading case in New York, it appeared that the defendants, being brokers, received in the course of their business, a certain number of shares of stock to hold as collateral for the payment of a note given them by the plaintiff, with the agreement that they should be at liberty, in case the note was not paid when due, to sell the stock at once, crediting the plaintiff with any surplus, and holding him liable for any deficiencies. The shares of the plaintiff were not marked or identified as his special property, but were blended with other shares of the same stock belonging to the defendants. It was held that, as the defendants at all times since securing the note were possessed of shares standing in their names, and under their absolute and rightful control, and subject to no contract, to an amount far exceeding the number of shares deposited by the plaintiff, and were ready and able at any time, to transfer the shares of the plaintiff on payment of the note,— they were not bound to account to the plaintiff for his stock at the *highest price* at which the shares were sold by them at any time during that period; but that the like number of shares held by the defendants when the note became due, were to be considered the shares of the plaintiff, which the defendants could sell.[4] - - - - The principle is also well illustrated by a case in California, where a bailee of shares of stock, the certificates of

[1] Nourse *v.* Prime, 4 Johns. Ch. 490, per Kent, Chancellor.

[2] Nourse *v.* Prime, 4 Johns. Ch. (N. Y.) 490; *s. c.* 8 Am. Dec. 606; Gilpin *v.* Howell, 5 Pa. St. 41, 57; *s. c.* 45 Am. Dec. 720, 727.

[3] Ketchum *v.* Bank of Commerce, 19 N. Y. 511.

[4] Nourse *v.* Prime, 4 Johns. Ch. (N. Y.) 490; *s. c.* 8 Am. Dec. 606.

which bore particular numbers, converted them to his own use, but delivered to the bailor other shares in the same company of the same series and denomination, the certificates of which bore different numbers. It was held that this was not such a conversion as would give the bailor a right of action for damages against the bailee.[1]

§ 2646. Analogous Holdings as to the Identity of Shares. — So, a contract by which A. *sells* to B. 100 shares of the capital stock of a particular corporation, is not a contract to sell 100 shares as evidenced by a certificate of a particular number, but 100 shares generally. If in such a case the contract provides for the delivery of the shares at a future date, it will give the vendee no right of action that the vendor, on the arrival of that date, had not in point of fact the particular shares in his possession, since *non constat* but he could easily procure the same in the market.[2] Nor will it be any defense, where the vendee brings an action for a breach of a contract to deliver shares of stock on a future date, that on the day previous to the last day on which the shares were deliverable, the plaintiff had none of the shares in his possession.[3] Cases of this kind do not fall within the rule that where a person enters into an obligation to do a thing which from its nature is incapable of performance, or where, subsequently to entering into an obligation to do a thing, he, by his own act, disables himself from performance, an action at once lies by the other party to recover the money advanced in consideration of the agreement.[4] In like manner, it has been held that a contract for the sale of a certain number of shares of railway stock, by which the vendee obligates himself to transfer to the vendor the same number of shares at a future day for a specified price, does not, without a stipulation to that effect, require the vendee to keep and re-transfer the same identical certificates of stock which were transferred to him.[5]

§ 2647. Distinction between Shares of Stock Pledged to Secure a Debt and Fungibles in the Scotch Law. — The doctrine of *fungibles* in the Scotch law, as stated by Senator Wright as referring

[1] Atkins *v.* Gamble, 42 Cal. 86, 100, 101; *s. c.* 10 Am. Rep. 282. The court examine and distinguish the following cases: Wilson *v.* Little, 2 N. Y. 443; Dykers *v.* Allen, 7 Hill (N. Y.), 497; *s. c.* 42 Am. Dec. 87, per Walworth, C.; Brookman *v.* Rothschild, 3 Sim. 153; Seymour *v.* Wickoff, 10 N. Y. 213; Ford *v.* Hopkins, 1 Salk. 283; Thompson *v.* Tolland, 48 Cal. 99, 116; Allen *v.* Dykers, 3 Hill (N. Y.), 593, 597, per Nelson, J.

[2] Frost *v.* Clarkson, 7 Cow. (N. Y.) 24.

[3] Shales *v.* Seignoret, 1 Ld. Raym. 440.

[4] Hogan *v.* Shee, 2 Esp. 522; Raymond *v.* Bearnard, 12 Johns. (N. Y.) 274; *s. c.* 7 Am. Dec. 317. See also Giles *v.* Edwards, 7 T. R. 181.

[5] Noyes *v.* Spaulding, 27 Vt. 421.

to the loan of things which are to be *used*, such as money, corn, wine, etc., and hence a disposition of them by the pledgee is not inconsistent with the contract of loan. A loan of money, corn or wine, presupposes that the article loaned will be used and return made, not of the article itself, but in kind. But, as he reasoned, in the case of stock parted with by its owner to secure an advance of money, there is nothing resembling a loan. It is simply a *pledge* of the stock and hence all the learning in relation to the doctrine of fungibles is inapplicable.[1] In the same case Chancellor Walworth, referring to the doctrine of fungibles in its application to a *loan* of stock, said: "There is no doubt that, upon an ordinary loan of 100 shares of the stock of a particular corporation, or of other stock of the like nature, where one share of the stock is just as good as another, it would only be necessary to return the same amount of stock in kind. The loan in such a case is in substance a sale, to be repaid in kind and quantity, and the title to the fungibles loaned is immediately transferred to the bearer; whereas upon the loan of specific articles to be returned in specie, the title remains in the lender, and the bearer is only entitled to the temporary use thereof.[2] But fungibles, or such articles as are capable of being estimated generally by weight, number, measure, do not, when deposited as a pledge, become the property of the pledgee, as they do upon a loan of them; for the pledge is not for use, but merely as a security. If the pledgee therefore sells the pledge without authority, it is a violation of his trust, although he afterwards purchases other articles of the same kind and value, to be returned to the pledgor; unless there is some agreement, either express or implied, between the parties that he shall be permitted to do so." [3]

§ 2648. Rule not Applicable to the Case of Shares of Different Values or Kinds.—This rule has, of course, no application where the corporation has two kinds of stock of different values in the market, and where the bailee converts the more valuable stock, and offers to return an equal number of shares of the less valuable kind. In such a case it has been well said that the bailee is bound to restore the identical stock pledged.[4]

§ 2649. Pledgee Liable if he does not Keep in Hand the Same Kind and Number of Shares. — On the other hand, where

[1] Dykers *v.* Allen, 7 Hill (N. Y.), 497, 502; *s. c.* 42 Am. Dec. 87; affirming *s. c.* 3 Hill (N. Y.), 593.

[2] Citing 3 Ersk. Inst. tit. 1, § 18.

[3] Dykers *v.* Allen, 7 Hill (N. Y.), 498; *s. c.* 42 Am. Dec. 87.

[4] Wilson *v.* Little, 2 N. Y. 443; *s. c.* 51 Am. Dec. 307.

a broker to whom shares are pledged by his customer sells the shares contrary to the terms of the pledge, *and does not keep on hand the same number of the same kind of shares*, it will be a *breach of trust and a conversion*, and in an action for damages therefor it will be no defense that he *afterwards* tendered to the plaintiff the proper amount of the same kind of shares.[1] Nor will it be any defense to a claim arising from such an unlawful conversion that the defendant was at all times *afterwards* either actually possessed of, or had the means of immediately obtaining, other shares of stock in the same company, of *equal value* with those disposed of, which he was ready and intended, whenever called upon, to substitute for those belonging to the plaintiff which he had disposed of.[2]

§ 2650. Custom to Re-hypothecate or Otherwise Use the Pledge. — In an action by a pledgor against his pledgee, a broker, for the conversion of certain shares delivered to the latter in pledge, the defendant offered to prove a custom and usage by which a broker was authorized to hypothecate or otherwise use securities received by him as margins on transactions like the one in question, and that the plaintiff had knowledge of this custom. It was held that no error was committed in rejecting this offer of evidence. Allen, J., said: "The right to sell the

[1] Allen *v.* Dykers, 3 Hill (N. Y.), 593; *s. c.* affirmed sub nom. Dykers *v.* Allen, 7 Hill (N. Y.) 497; 42 Am. Dec. 87. Compare Duggan *v.* London &c. Co., 19 Ont. 272, 278.

[2] Parsons *v.* Martin, 11 Gray (Mass.), 111, 117. The reasoning of the court in this case, though not necessary to the decision, goes against the doctrine of the New York and California cases, that there is a conversion where the broker actually keeps on hand of his own a like number of shares of stock in the same company, though not the same certificates which he holds of the plaintiff. "The misappropriation," said Merrick, J., "had already taken place; the wrong had been done, and the right to an adequate remedy had already accrued. The shares which the plaintiff had owned could no longer be identified; and there was no pretense therefore that they could ever be restored to him. He was not bound to take others in their stead, but was entitled to recompense for those which had been unlawfully taken from him." *Ibid.* 117. But it should be observed that there was no such element in the defense set up as that the defendant actually retained in his own possession, belonging to himself and subject to his disposal, the like number of shares of the same kind of stock in the same company with which he could at any time have responded to the plaintiff's demand and discharge his contract with the plaintiff.

stocks, and to change the title absolutely would have been inconsistent with the contract of the parties, and the rights and obligations resulting from the transaction. The claim is that the usage and custom sought to be proved was not incompatible with the contract, and upon the ground that it did not destroy the essential characteristics of a pledge. The offer was to prove a custom and usage known to the plaintiff, and which, therefore, entered into and formed a part of the contract, by which brokers may use, by hypothecation or otherwise, securities received by them as a margin on transactions of the character of that between the plaintiff and defendant. This custom, if proved as offered, did not authorize a sale of the stock, or any use or disposition of it by which the pledgor would be deprived of his property. The use of the pledge contemplated by the custom embraced in the offer was only such as consisted with the rights of the pledgor to the property, upon making full indemnity to the pledgee, and would only affect the rights of the parties to the extent of permitting a hypothecation, or such other use of the pledge as should not destroy the property or right of property of the pledgor, or deprive him of the right to reclaim the pledge in specie." [1]

2651. Doctrine that Pledgee Bound to Return Identical Certificates.— Contrary to the foregoing, there is a limited view that the pledgee is bound, at the election of the pledgor, to return the identical certificates pledged.[2] According to this view, one who has pledged a certificate of stock as collateral security may treat a transfer thereof by the pledgee to a creditor of the pledgee as a *conversion*, although the pledgee has a greater number of shares standing to his credit on the books of the corporation.[3]

§ 2652. Grounds of these Conflicting Theories. — Much of the confusion under this head has arisen from the failure of the courts to discriminate between the share certificate and the shares themselves,— the shares being, as already pointed out,[4] the

[1] Lawrence *v.* Maxwell, 53 N. Y. 19, 21. To the same effect see Dykers *v.* Allen, 7 Hill (N. Y.), 497; *s. c.* 42 Am. Dec. 87.

[2] Langton *v.* Waite, L. R. 6 Eq. 165.

[3] Fay *v.* Gray, 124 Mass. 500.

[4] *Ante*, § 2451, *et seq.*

property, and the certificate merely the paper representative or muniment of the title of the shareholder. The inquiry, then, is whether the subject is merely a pledge of so many shares, or whether it is a pledge of so many shares and *also* of the particular certificate which represents them. The doctrine that the pledgee is guilty of the *conversion* of the shares whenever, during the pendency of the debt secured by the pledge, he exercises acts of dominion over the share certificate which has been delivered to him in pledge, so that he disables himself from restoring that *particular certificate*, must be either a very technical doctrine, or else it must be made to rest on a principle of public policy which will not uphold the pledgee in dealing with the pledge in any way as his own property, but which, on principles of business morality and honesty, requires him to put it in his safe, or in the safe of his banker or safe deposit company, and there keep it securely until the debt is paid or his right to sell it accrues. The former theory, which will not allow the pledgee to restore to his pledgor *other certificates*, representing the same number of shares of the same series, rests on grounds which seem on the one hand technical, and on the other, productive of a better business morality than that which usually characterizes the stock exchanges. Nor can the court safely assume, as they seem to have done in some of the preceding cases, that the pledgor gets back the pledge when the pledgee returns to him the same number of other certificates of the same series of shares in the same corporation; for the certificate which was the subject of the pledge may represent *genuine shares* of that series, while the certificate returned may represent a *fraudulent over-issue*, — a circumstance which might not become known for years.[1] In such a case the certificate returned would be no share certificate at all, but would be merely the foundation of a right of action against the corporation for indemnity.[2] The act of the pledgee might thus deprive the pledgor of his membership in the corporation, which might be incidentally far more valuable to him than the market value of his shares. However remote

[1] The fraudulent over-issues known as "the Schuyler Frauds" had been carried on by Schuyler for *six years*, from 1848 to 1854, before they were detected. New York &c. R. Co. *v.* Schuyler, 34 N. Y. 36, 39.

[2] *Ante*, § 1493.

such a contingency may be, it can not be justly said that he is not entitled to a choice which will preclude the possibility of such a risk. If a man who pawns a brass watch is not bound to take a gold watch in return, surely the man who pledges a genuine share certificate is not bound to take in return one which may possibly be fraudulent and no share certificate at all.

§ 2653. Pledgee no Right to Sell before Maturity.—According to this last view, the pledgee has no right to sell before maturity, whether he keeps on hand a like number and kind or not; and if he does so he is chargeable with the price produced by the sale, whatever may be the subsequent reduction in its value.[1] But, according to the former view, if the pledgee, before maturity of the debt and without authority in the terms of the contract of pledge, sells the shares, *and does not keep in hand the same number and kind of shares*, this will render him liable to the pledgor for a *breach of trust*, and he can not discharge this liability by afterwards purchasing other shares of the *same denominations and value* with which to replace those which he has sold.[2]

Article IV. Enforcing the Contract.

[1] Ex Parte Dennison, 3 Ves. Jr. 552; Langton *v.* Waite, L. R. 6 Eq. 165.

[2] Dykers *v.* Allen, 7 Hill (N. Y.), 497; *s. c.* 42 Am. Dec. 87; affg. *s. c.* 3 Hill (N. Y.), 593.

§ **2656. Ordinary Remedies of Pledgee.** — The ordinary remedies of a pledgee are: 1. To proceed personally against the pledgor for his debt, without first selling the collateral security.[1]

[1] Sonoma Valley Bank *v.* Hill, 59 Cal. 107; Stover *v.* Flack, 41 Barb. (N. Y.) 162; Jones *v.* Scott, 10 Kan. 33; and see Hendrix *v.* Harman, 19 S. C. 483. By pursuing this course, he does not destroy or impair his lien upon the property pledged. Ehrlich *v.* Ewald, 66 Cal. 97; *s. c.* 4 West. Coast Rep. 380; Butterworth *v.* Kennedy, 5 Bosw. (N. Y.) 143; Archibald *v.* Argall, 53 Ill. 307; Darst *v.* Bates, 95 Ill. 493 and 509; Smith *v.* Strout, 63 Me. 205. It follows from this that he is not required to return the pledge before bringing such an action, unless there is a stipulation in the contract of pledge to that effect. Taylor *v.* Cheever, 6 Gray (Mass.), 146; Darst *v.* Bates, *supra*; Lormer *v.* Bain, 14 Neb. 178; Bank of Rutland *v.* Woodruff, 34 Vt. 89; American Nat. Bank *v.* Harrison Wire Co., 11 Mo. App. 446; Lewis *v.* United States, 92 U. S. 618; West *v.* Carolina Ins. Co., 31 Ark. 476. Nor can the pledgee, or those sued, set up the value of the pledge by way of *set-off* or recoupment. Winthrop Sav. Bank *v.* Jackson, 67 Me. 570; *s. c.* 24 Am. Rep. 56. Though in some jurisdictions damages for the conversion of the pledge will avail as a defense if the conversion is established. Cass *v.* Higenbotam, 100 N. Y. 248. So, loss to pledgor by *negligence* of pledgee may be set up by way of *counter-claim*. Scott *v.* Crews, 2 S. C. 522. See also Stearns *v.* Marsh, 4 Denio (N. Y.), 227; *s. c.* 47 Am. Dec. 248; Douglass *v.* Mundine, 57 Tex. 344. Where this rule prevails, the pledgee must in such action either produce the collateral security or account for its nonproduction. Stuart *v.* Bigler, 98 Pa. St. 80; Ocean National Bank *v.* Fant, 50 N. Y. 474. An attachment by the pledgee of the thing pledged is in general a waiver of his lien. Buck *v.* Ingersoll, 11 Metc. (Mass.) 226; Evans *v.* Warren, 122 Mass. 303; and see Sickles *v.* Richardson, 21 Hun (N. Y.), 110. But of course in a jurisdiction where an action against the pledgor is not a waiver of the pledgee's lien, he will not waive it by attaching other property of the pledgor in such an action. Taylor *v.* Cheever, 6 Gray (Mass.), 146, 148. As to the

2. To file a bill in chancery, and have a judicial sale under a regular decree of foreclosure.[1] 3. To sell without judicial process, upon giving reasonable notice to the debtor to redeem.[2]

§ 2657. **His Right of Action.** — A pledgee of stock may sue in his own name to protect his interest, as such, in the property

effect of an attachment where corporate shares have been pledged, see Norton *v.* Norton, 43 Oh. St. 509. The writer is in debted for the matter of this note to 79 Am. Dec. 500, where the reader will find a learned note on the general subject of pledge.

[1] At common law the pledgee, in the absence of a special contract to the contrary, could only obtain a sale of the pledge under a judicial decree. Cortelyou *v.* Lansing, 2 Caines Cas. (N. Y.) 200; Ogden *v.* Lathrop, 1 Sweeny (N. Y.), 643, 647. Such, it seems, is the rule of the civil law (Hart *v.* Ten Eyck, 2 Johns. Ch. (N. Y.) 62 and 99), and under the civil code of Louisiana. Brother *v.* Saul, 11 La. An. 223. The right to come into equity to obtain a decree of sale still exists, in the absence of a special provision to the contrary, in the contract of pledge. Ogden *v.* Lathrop, *supra*; Sitgreaves *v.* Farmers &c. Bank, 49 Pa. St. 359; Smith *v.* Coale, 12 Phila. (Pa.) 177; Briggs *v.* Oliver, 68 N. Y. 336; Cal. Civ. Code, § 3011. Compare Durant *v.* Einstein, 35 How. Pr. (N. Y.) 223; *s. c.* 5 Rob. (N. Y.) 423, where the jurisdiction of equity is denied except under special circumstances. This course may be safer and more advantageous in many cases, for obvious reasons, than to make a non-judicial sale of the pledge. Boynton *v.* Payrow, 67 Me. 587; Conyngham's Appeal, 57 Pa. St. 474. It may be even necessary in some cases, as where the pledgor has not waived his right to notice and can not be found, to be personally served with notice to redeem. Stearns *v.* Marsh, 4 Denio (N. Y.), 227; *s. c.* 47 Am. Dec. 428; Indiana &c. Co. *v.* McKernan, 24 Ind. 62. In such a suit the pledgor will not be allowed to set up as a defense that he gave the pledge with intent to defraud his creditors, for a conveyance void as to creditors is nevertheless good as between the parties to it. Chafee *v.* Sprague Man. Co., 14 R. I. 168. The writer acknowledges his indebtedness for these citations to 79 Am. Dec. 503.

[2] 2 Kent. Com. 582; Tucker *v.* Wilson, 1 P. Wms. 260; Robinson *v.* Hurley, 11 Ia. 410; Brightman *v.* Reeves, 21 Texas, 70; King *v.* Insurance Co., 58 Texas, 669; Wilson *v.* Brannan, 27 Cal. 258; Pigot *v.* Cubley, 15 Com. B. (N. S.) 701; Stevens *v.* Hurlbut Bank, 31 Conn. 149; Merchants Bank *v.* Thompson, 133 Mass. 482. This power of sale is ordinarily an incident of the pledge, in such a sense that it follows the debt into the hands of an assignee, the same as the power of sale in a mortgage deed of trust follows an assignment of the notes secured by the mortgage. Alexandria &c. R. Co. *v.* Burke, 22 Gratt. (Va.) 254. But the pledgee is not bound on default to sell the thing pledged, even after notice from the pledgor so to do. Field *v.* Leavitt, 5 Jones & S. (N. Y.) 215; Napier *v.* Central &c. Bank 68 Ga. 637. The equitable right of *redemption* does not exist in respect of a *mortgage* of stocks; that right extends only to mortgages of *land*. Lockwood *v.* Ewer, 2 Atk. 303.

of the corporation, and is not required to act through the corporation.[1]

§ 2658. **Effect of Statute of Limitations.** — The pledgee of corporate stock has the right to retain it until the debt for which it was pledged is fully satisfied. But during the time that he so holds it, he can not assert that he holds it *adversely*, and thereby acquire it under the statute of limitations.[2]

§ 2659. **Right of Pledgee to Sell Stocks or Bonds.** — As the only way to realize on such securities is by selling them, it is a fair presumption that the parties to a contract of pledge of corporate stocks or bonds contemplated a sale of them, after demand and notice, in the absence of an express contract, in case the debt for which they were pledged should not be punctually paid.[3] The rule may, therefore, be stated to be that, in the absence of a special contract providing for the mode in which the pledgee shall employ the pledged securities, he may sell them upon default in payment of the debt, as the readiest mode of realizing their value.[4]

§ 2660. **Whether the Pledgee Bound to Sell.** — While the pledgee is at liberty to sell after default, he is not bound to do so, at least without being so required by the pledgor.[5] He may exercise his own judgment as to the expediency of selling, and

[1] Baldwin *v.* Canfield, 26 Minn. 43.

[2] Cross *v.* Eureka &c. Canal Co., 73 Cal. 302; *s. c.* 2 Am. St. Rep. 808.

[3] Morris Canal &c. Co. *v.* Lewis, 12 N. J. Eq. 323; Water Power Co. *v.* Brown, 23 Kan. 676.

[4] Brown *v.* Ward, 3 Duer (N. Y.), 660; Alexandria &c. R. Co. *v.* Burke, 22 Gratt. (Va.), 254; Canfield *v.* Minneapolis &c. Asso., 14 Fed. Rep. 801. In action by the pledgee against the pledgor for a balance remaining unsatisfied after the sale, it is not necessary to allege notice of the sale, this being matter of defense. Duden *v.* Waitzfelder, 23 Hun (N. Y.), 337. In Colket *v.* Ellis, 10 Phila. (Pa.) 375, it was held that a custom to sell collateral deposited to secure a call loan, on the day of demand, was a good custom, although the sale was not a public sale or after notice to the pledgor. The case proceeds on the ground of the parties being familiar with and dealing on the basis of the custom.

[5] O'Neill *v.* Whigham, 87 Pa. St. 394; Richardson *v.* Ins. Co., 27 Gratt. (Va.) 749; Colquitt *v.* Stultz, 65 Ga. 305; Napier *v.* Central &c. Bank, 68 Ga. 637; Newsome *v.* Davis, 133 Mass. 343.

is liable to the pledgor only for negligence,[1] or, of course, bad faith.

§ 2661. **Pledgee Bound to use Diligence in Realizing upon the Security.**— The pledgee, being in part a trustee for the pledgor, is bound to use *good business diligence* in making his debt out of the security, and in making the security bring the largest practicable price. He is chargeable in favor of the pledgor, not only with what he actually received from the sale of the security, but with what he might have received but for his own *laches*, or by the exercise of good business diligence.[2]

§ 2662. **Must not sell More than Necessary to Pay Debt.**— Unless the contract of sale otherwise specifies, the pledgee must not sell more of the chattels pledged than is necessary to pay the debt thereby secured. But if he does sell more than is necessary, the sale is not void, but voidable only at the instance of the pledgor.[3]

2663. **Whether a Mortgagee is Bound to See to Enforcing Contract of Sale.** — It has been held in the Ontario Court of Appeal, after very thorough consideration, one judge dissenting, that where shares are mortgaged to a lender of money to secure the debt with a power in him to sell the same, and he executes the power and sells the shares, but the purchaser refuses to comply with the contract of purchase on his part,— the mortgagee is not liable to the mortgagor, upon the footing of negligence or breach of trust, for failing to bring an action against such purchaser to compel him to perform his contract of purchase. A majority of the court reasoned that the mortgagor could at any time have paid the mortgagee's claim and could then have taken proceedings against the purchaser, and, not having done so, was not entitled to complain.[4]

[1] Franklin Savings Institution *v.* Preetorius, 6 Mo. App. 470.

[2] Barrow *v.* Rhinelander, 3 Johns. Ch. (N. Y.) 614; Lawrence *v.* McCalmont, 2 How. (U. S.) 427; Wakeman *v.* Gowdy, 10 Bosw. (N. Y.) 208; Pickens *v.* Yarborough, 26 Ala. 417; *s. c.* 62 Am. Dec. 728; Slevin *v.* Morrow, 4 Ind. 425; Franklin Savings Ins. *v.* Preetorius, 6 Mo. App. 470, 473; Williams *v.* Price, 1 Sim. & St. 581.

[3] Whitlock *v.* Heard, 13 Ala. 776; *s. c.* 48 Am. Dec. 73.

[4] Daniels *v.* Noxon, 17 Ont. App. 206; *s. c.* 30 Am. & Eng. Corp. Cas. 98. Upon the point that the mort-

§ 2664. When the Pledgee must Collect and not Sell. — In the case of a pledge of ordinary *commercial paper* the pledgee has no implied authority to sell the security upon default of payment, either at public or private sale; but, to justify such a sale, there must be a special power of sale conferred upon him in the contract of pledge. On the contrary, it is his duty to collect the paper when it falls due, apply enough of the proceeds to pay his debt, and return the balance to the pledgor.[1] On principle, this rule should apply in the case of a pledge of *bonds* which, at the time of default on the part of the pledgor, have attached to them *coupons* which are past due. Good business diligence, and hence the rule which the law would imply in the absence of an express contract, would require the pledgee to collect the *coupons*, although he might be justified in selling the *bonds*. But it has no application to pledges of corporate stock. In Fletcher *v.* Dickinson,[2] it is said by the court, speaking through Chapman, J.: "The holder of stocks and bonds of a corporation as collateral may sell them, because that is the usual method of turning such securities into money; but it is held that the sale must be at *public auction*, after *demand* for payment and due notice of the sale." This clearly exhibits the distinction intended to be conveyed in the text. Contrary to the doctrine of the text, it has been held by the Supreme Court of Rhode Island that the pledgee of a *negotiable note* has authority to sell it after maturity, as he is not bound to take upon himself the expense of a suit in equity to foreclose his lien upon it.[3] The case of Zimpleman *v.* Veeder,[4] recog-

gagor might have sued the purchaser the court cited and relied on Paddon *v.* Richardson, 7 De Gex M. & G. 563. The court further reasoned that if the mortgagor had desired the mortgagee to sue, she should at least have requested him to do so, putting funds in his hands for that purpose; citing Cochs *v.* Gray, 1 Giff. 77; Job. *v.* Job, 6 Ch. Div. 562. The court also laid stress on the doctrine of Warner *v.* Jacob, 20 Ch. Div. 220, 224, where it was said by Kay, J., after reviewing the authorities: "The result seems to be that a mortgagee is, strictly speaking, not a trustee of the power of sale. It is a power given to him for his own benefit, to enable him the better to realize his debt. If he exercises it *bona fide* for that purpose, without corruption or collusion with the purchaser, the court will not interfere." This doctrine was re-affirmed by North, J., in Martinson *v.* Clowes, 21 Ch. Div. 860. See also Palmer *v.* Jones, 1 Vern. 144; Pybus *v.* Smith, 1 Ves. 193; Wilson *v.* Lord Bury, 5 Q. B. Div. 518; Speight *v.* Gaunt, 22 Ch. Div. 727; *s. c.* 9 App. Cas. 1 and 15.

[1] Cole *v.* Dalziel, 13 Ill. App. 23; Union Trust Co. *v.* Rigdon, 93 Ill. 458; Joliet Iron *v.* Scioto Fire Brick Co., 82 Ill. 548; *s. c.* 25 Am. Rep. 341 (extending the rule to pledges of bonds, payable upon condition); Fletcher *v.* Dickinson, 7 Allen (Mass.), 23; Moody *v.* Andrews, 7 Jones & S. (N. Y.) 302; Wheeler *v.* Newbould, 16 N. Y. 392.

[2] 7 Allen (Mass.), 25.

[3] Potter *v.* Thompson. 10 R. I. 1, 8.

[4] 98 Ill. 613.

nizes the doctrine of the text but holds that the sale by the pledgee of a promissory note which was the subject of the pledge was valid, because authorized by a special power.

§ 2665. Interpretation of Express Powers of Sale.—Where an express power of sale is given in the contract of pledge, it will, unless it is otherwise specified, be interpreted as giving the power to sell only upon a *reasonable notice* to the pledgor to redeem, and also upon a reasonable notice of the time and place of sale.[1] Nor does the superaddition of a power to sell, which, without an express agreement, would not exist, take away by implication the power which ordinarily exists on the part of the pledgee, of proceeding by any other mode,—of enforcing the collection of the debt by any remedy which the law gives him.[2] A power to sell the pledge is a *power coupled with an interest*, and passes to the legal representatives of the pledgee,[3] to his assignees, or to his executor or administrator.

§ 2666. Express Authority as to Sale Excludes Implied Authority.— Express authority in a contract of pledge to sell the pledge for non-payment of the debt at maturity, excludes any implied authority to sell before maturity.[4]

§ 2667. Effect of Authority to Sell at Board of Brokers.— Express authority to sell the shares pledged at the board of brokers, in case of forfeiture, does not authorize a sale made otherwise than openly at the board after stating the facts.[5]

§ 2668. Notice and Mode of Sale.—As shown in a preceding section,[6] in the absence of a special agreement to the contrary, the sale cannot take place without *notice to the pledgor to redeem*, and without notice to him of the time and place of sale (unless he knows it already); and unless otherwise agreed, the sale must be at *public auction*.[7] In an ordinary case of pledge, the

[1] Goldsmidt *v.* First M. E. Church, 25 Minn. 202.

[2] Nelson *v.* Wellington, 5 Bosw. (N. Y.) 178.

[3] Chapman *v.* Gale, 32 N. H. 141, 143.

[4] Dykers *v.* Allen, 7 Hill (N. Y.), 497; *s. c.* 42 Am. Dec. 87.

[5] Dykers *v.* Allen, 7 Hill (N. Y.), 497; *s. c.*, 42 Am. Dec. 87.

[6] *Ante*, § 2665.

[7] Genet *v.* Howland, 30 How. Pr.

pledgee has no right to sell without notice to the pledgor,[1] unless such notice is waived. Where the pledge is for an indefinite period of time, he must first give reasonable notice to the pledgor to redeem,[2] and if the pledge is not redeemed and he proposes to sell it, he must sell it at public sale, but only after notice to the pledgor of the time and place of sale.[3] If this be not done, the pledgor's rights are unaffected by the sale.[4] Some of the decisions state the doctrine of the text in a different form, by saying that the pledgee can not dispose of the securities until payment of the debt has been demanded and refused.[5] The pledgor may, of course, *waive* notice of sale, and thereby *estop* himself from complaining that the pledge has been sold without notice.[6] But, although the right to *notice* of the time and place of sale is expressly *waived* in the contract of pledge, this, it has been held, does not amount to a *waiver of demand* of payment.[7]

§ 2669. Doctrine that where the Pledgee Purchases the Pledge at his Own Sale, there can be no Conversion. — A

(N. Y.) 360; *s. c.* 45 Barb. (N. Y.) 560; Conyngham's Appeal, 57 Pa. St. 474; Diller *v.* Brubaker, 52 *Id.* 498; *s. c.* 91 Am. Dec. 177. But knowledge and participation on the part of the pledgor may estop him from complaining that the sale was private. Ex parte Fisher, 20 S. C. 179. In Alabama, where a stockholder, as security for a loan, causes his shares to be transferred to the lender on the books of the corporation, as provided by the Ala. Rev. Code, Secs. 1783-87, the transaction is a pledge, and not a mortgage, and the lender has no right to sell or transfer the shares to another, without demanding payment of the debtor, or giving him notice of the intention to sell; nor can the lender sell at private sale for less than the market value of the shares. Nabring *v.* Bank of Mobile, 58 Ala. 204.

[1] Conyngham's Appeal, 57 Pa. St. 474.

[2] Alexandria &c. R. Co. *v.* Burke, 22 Gratt. (Va.) 254, 263; Stearns *v.* Marsh, 4 Denio (N. Y.), 227; *s. c.* 47 Am. Dec. 248; Garlick *v.* James, 12 Johns. (N. Y.) 146; *s. c.* 7 Am. Dec. 294; Wilson *v.* Little, 2 N. Y. 443; *s. c.* 51 Am. Dec. 307.

[3] Stearns *v.* Marsh, 4 Denio (N. Y.), 227; *s. c.* 47 Am. Dec. 248; Bryan *v.* Baldwin, 52 N. Y. 232; Ogden *v.* Lathrop, 65 N. Y. 158, 162; Lewis *v.* Graham, 4 Abb. Pr. (N. Y.) 106, 110; Wilson *v.* Little, 2 N. Y. 443, 448; *s. c.* 51 Am. Dec. 307; Wheeler *v.* Newbould, 16 N. Y. 392, 400; Strong *v.* National Mechanics Banking Assn., 45 N. Y. 718; Porter *v.* Parks, 49 N. Y. 564, 569.

[4] Morgan *v.* Dod, 3 Colo. 551; Ogden *v.* Lathrop, 65 N. Y. 158; Rosenweig *v.* Fraser, 82 Ind. 342.

[5] Wilson *v.* Little, 2 N. Y. 443; Lewis *v.* Varnum, 12 Abb. Pr. 308.

[6] Fitzgerald *v.* Blocher, 32 Ark. 742; *s. c.* 29 Am. Rep. 3.

[7] Wilson *v.* Little, 2 N. Y. 443; *s. c.* 51 Am. Dec. 307.

decision of the Court of Appeals of New York seems to involve the aberration of holding that if the pledgee exposes the pledge to sale, though without giving to the pledgor the notice which the pledgor is entitled to receive, and the pledgee bids in the pledge at his own sale, this does not entitle the pledgor to maintain an action against him for the converson of the pledge. The court reason that the only thing effected by such a sale is a purchase which the pledgor can ratify and thus make valid, or disaffirm and thus make it a nullity. If he ratifies it, it will have the effect of making it lawful in all respects as though the notice had been received by him. If he disaffirms it, it becomes a nullity and therefore no conversion.[1] This seems to overlook the elementary principle that any exercise of dominion over the property of another to the exclusion of his legal rights, whatever form it takes, is a conversion.[2]

§ 2670. Power to Sell without Notice not a Power to Sell without Demand. — Although the contract of pledge may confer upon the pledgee the power to sell the pledge *without notice* to the pledgor, yet this does not necessarily carry with it the power to sell it without *demanding payment* of the pledgor. It is said to be well settled that where no time is expressly fixed by contract between the parties for the payment of a debt secured by a pledge, the pledgee can not sell the pledge without a previous demand of payment, although the debt is technically due immediately.[3]

§ 2671. Custom of Selling at Private Sale without Notice Void. — A custom of brokers to sell stocks and bonds pledged as securities for a loan, at private sale, without notice to redeem and without notice of the time and place of the intended sale, is illegal and void.[4]

[1] Bryan *v.* Baldwin, 52 N. Y. 232.

[2] Cooley Torts, 448; Webber *v.* Davis, 44 Me. 147, 152; *s. c.* 69 Am. Dec. 87; McPheeters *v.* Page, 83 Me. 234; *s. c.* 23 Am. St. Rep. 772; Reid *v.* Colcock, 1 Nott. & McCord (S. C.), 592; *s. c.* 9 Am. Dec. 729; Allen *v.* Crary, 10 Wend. (N. Y.) 319; *s. c.* 25 Am. Dec. 566; Hale *v.* Ames, 2 T. B. Mon. (Ky.) 143; *s. c.* 15 Am. Dec. 150; note, 15 Am. Dec. 151.

[3] Wilson *v.* Little, 2 N. Y. 443, 448; *s. c.* 51 Am. Dec. 307. See also McNeil *v.* Tenth Nat. Bank, 55 Barb. (N. Y.) 59.

[4] Wheeler *v.* Newbould, 16 N. Y. 392; Case where the notice was held sufficient although it did not specify the *place* of sale: Worthington *v.* Tormey, 34 Md. 182.

§ 2672. This Right to Notice may be Waived by Contract. — It is of course competent for the parties to the contract of pledge to regulate therein the remedy to which the pledgee must resort in case of default in payment of the debt,[1] provided the agreement be not in contravention of the statute law, against public policy, or fraudulent.[2] But the authorities seem to be unanimous that this right to notice may be *waived* by the pledgor, by a stipulation to that effect in the contract of pledge. Thus, it is said by a recent writer of authority: "A waiver of the requirement of notice of the pledgee's intention to sell, and of the time and place of sale, may be made by agreement of parties. A waiver of the common law rule of notice is generally made when the parties agree upon a special power of sale; for under such a power, it is usual either to waive notice of sale altogether, or else to provide for a special notice. Such notice is waived by giving the pledgee the option to sell at private sale. Under authority given a pledgee to sell at public or private sale at his option, he may sell without notice, in the usual manner of selling such property in the market."[3] If the pledgor asserts the existence of an agreement providing for a special remedy to be pursued by him, it is of course incumbent upon him to show it.[4]

§ 2673. Notice to Redeem not Necessary where Time of Payment Fixed. — Moreover, it has been ruled that where the parties by contract expressly fix the time for the payment of the debt secured by the pledge, no prior demand upon the pledgor is necessary,—which is equivalent to saying that no prior notice to him to redeem is necessary.[5]

§ 2674. Circumstances Dispensing with Special Notice. — It is obvious that special notice to the pledgor of the time and place of sale will not be necessary, if he actually knows when it

[1] Union Trust Co. *v.* Rigdon, 93 Ill. 458.

[2] Baker *v.* Drake, 66 N. Y. 518; *s. c.* 23 Am. Rep. 80.

[3] Jones on Pledges, § 611. See to this effect Loomis *v.* Stave, 72 Ill. 623; Milliken *v.* Dehon, 27 N. Y. 364; Hamilton *v.* State Bank, 22 Ia. 306; Chouteau *v.* Allen, 70 Mo. 291, 329.

[4] King *v.* Insurance Co., 58 Tex. 669.

[5] Chouteau *v.* Allen, 70 Mo. 291, 331.

is to take place.[1] So, a sale without special notice may be *ratified* by the pledgor by participating in it.[2] So, where the giving of notice has been rendered impossible by the action of the pledgor himself, the power may be executed without notice.[3] This is a rule common to all obligations, that they be taken to be accomplished when the obligor has brought about such a condition as prevented the accomplishment of them.[4]

§ 2675. Pledgor cannot Require Sale to Take Place at any Particular Time. — "The pledgee has *jus in re aliena*, a special right in the pledgor's property for the purpose of compelling the pledgor to pay the debt. * * * The pledgor retains a double interest in his having his debt paid, and in a possible surplus. But, as the pledgee has taken possession, the pledgor can make a sale only through the pledgee. But if the pledgee has a right to make his claim out of the property, and it has been put into his hands for this purpose, how can it be said there is a right in the pledgor to require a sale at a given time? This virtually asserts in him a right he has surrendered with the pledge. To say that the debtor has an absolute right to require a sale at a given time, is to say that the creditor is not to exercise his judgment and skill in the management of his own special property. On the other hand, so far as the pledgor's interest is involved, the pledgee ought only to be responsible for negligence, not for a failure which may be consistent with diligence and even indicate vigilance and skill in calculating the chances of the market. The refusal to sell upon request of the debtor may, on the other hand, tend to show negligence or want of reasonable care, it being merely a fact to be considered with other facts."[5]

[1] Alexandria &c. R. Co. *v.* Burke, 22 Gratt. (Va.) 254. Compare Earle *v.* Grant, 14 R. I. 228; Child *v.* Hugg, 41 Cal. 519; Ex parte Fisher, 20 S. C. 179.

[2] Ex parte Fisher, *supra;* Earle *v.* Grant, *supra;* Child *v.* Hugg, *supra.* See also as to a ratification by the pledgee of a voidable sale, Hill *v.* Finigan, 62 Cal. 426.

[3] City Bank *v.* Babcock, 1 Holmes (U. S.), 180. So held where the pledgor was a bank which afterwards failed, closed its place of business, and thereafter transacted no business, and had no office nor acting officers. *Ibid.*

[4] Hotham *v.* East India Co., 1 T. R. 638; Williams *v.* Bank of United States, 2 Pet. (U. S.) 102.

[5] Franklin Savings Inst. *v.* Preetorius, 6 Mo. App. 470 and 472, opinion by Hayden, J. See also Richardson *v.* Insurance Co., 27 Gratt. (Va.) 749; Goodall *v.* Richardson, 14 N. H. 572.

§ 2676. Rights of the Parties in Case of a Sale of the Pledge Pending an Appeal and before Reversal. — In a recent case W. pledged certain certificates of stock to a bank, but no transfer was made on the books of the company. The stock was thereafter attached by other creditors of W., but the court held that the bank had the better right to it, and ordered a receiver to sell it, and have new certificates issued to the purchaser. The bank, through its cashier, became the purchaser, and paid the amount of its bid to the receiver, who returned the money to the bank, and new certificates were issued to it. On appeal it was held that the attaching creditors were entitled to priority over the bank, and the decree was reversed, and the case remanded. By this time the stock had become worthless, owing to the insolvency of the company.[1] The statute provided that "if, by the decision of the Supreme Court the appellant becomes entitled to a restoration of any part of the money or property that was taken from him by means of such judgment or order," he shall have execution or writ of restitution, "for the purpose of restoring to such appellant his property or the value thereof." It was held that the bank could not be required to turn over the amount it had bid for the original certificates, but could insist that the substituted stock in its hands be sold for the benefit of the attaching creditors. The fact that in the decree ordering a sale of the substituted stock the certificates were designated by wrong numbers affords no ground for reversal. The record can be corrected at any time.[2]

§ 2677. Pledgee Purchasing at his Own Sale. — It is obvious that the same person can not be both seller and buyer; and where a person acts as seller in a representative capacity and as buyer in his private capacity, his interest as seller is so antagonistic to his interest as buyer that the law will not permit such sales to stand. His interest as purchaser would allow him to obtain the property at a small price compared with its real value.[3] This rule applies to the case of a sale of corporate stock held by a pledgee. He can not become the purchaser at his own sale;[4] and if he attempt to do so and as such purchaser continues to hold possession of the certificates, the pledgor may maintain *trover* therefor.[5] If the pledgee purchases at his own sale, the

[1] Code Iowa, § 3198.

[2] Ft. Madison Lumber Co. *v.* Batavian Bank, 77 Ia. 393; *s. c.* 42 N. W. Rep. 331.

[3] For cases expounding and applying this rule see Pratt *v.* Thornton, 28 Me. 355; Parker *v.* Vose, 45 Me. 54.

[4] Story Bailm., § 319.

[5] Freeman *v.* Harwood, 49 Me. 195.

sale will be voidable at the option of the pledgor.[1] But such a sale is not absolutely void: the rule may be *waived* by an express agreement, or by the conduct of the parties; [2] or the act of the pledgee in thus purchasing may be subsequently *ratified* by the pledgor.[3] And the assent of the pledgor to the purchase by the pledgee may be *presumed*, where the facts are notorious and no dissent is shown.[4] A purchase by the pledgee at his own sale is not, however, a *conversion* of the pledge; but, if the pledgor disaffirms the act, the result merely is to leave the title of the pledgee to the pledge the same as though the sale had not taken place, and to leave his relation to the pledgor unchanged.[5] The reason is that to constitute a conversion, there must be a tortious detention of the property from the owner, or its destruction, or an exclusion or defiance of the owner's right, or a withholding of the possession under a claim of title inconsistent with that of the owner.[6] So, where there was no contract of sale of the stock, no money or other consideration paid or agreed to be paid therefor by the transferee, and the stock was taken back by indorsement in blank from the transferee, so that the stock remained under the control of the pledgee ready for delivery to pledgor on payment of the debt, it was held that there was no conversion.[7]

§ 2678. Equitable Relief in Such Case to Pledgor.—Where a pledgee of shares in a corporation has illegally sold them to himself and has had them transferred on the corporation books, so that they stand in his name as legal owner, equity

[1] Fire Ins. Co. *v.* Dalrymple, 25 Md. 242; Bank *v.* Minot, 4 Metc. (Mass.) 325; Thornton *v.* Irwin, 43 Mo. 153; Chouteau *v.* Allen, 70 Mo. 291, 335. So as to a sale of land by an *administrator:* Blood *v.* Hayman, 13 Metc. (Mass.) 231.

[2] Chouteau *v.* Allen, 70 Mo. 291.

[3] Hill *v.* Finigan, 62 Cal. 426. That pledgor may ratify defective sale for want of notice, see Child *v.* Hugg, 41 Cal. 519.

[4] Carroll *v.* Mullanphy Savings Bank, 8 Mo. App. 249; Hamilton *v.* State Bank, 22 Iowa, 306.

[5] Bryan *v.* Baldwin, 7 Lans. (N. Y.) 174; *s. c.* 52 N. Y. 232; Canfield *v.* Minneapolis &c. Asso., 14 Fed. Rep. 801; *s. c.* 4 McCr. (U. S.) 646; Terry *v.* Birmingham Nat. Bank, 93 Ala. 599; *s. c.* 30 Am. St. Rep. 87.

[6] Terry *v.* Birmingham Nat. Bank, *supra*; Penny *v.* State, 88 Ala. 106; *s. c.* 7 South. Rep. 50; Thweat *v.* Stamps, 67 Ala. 98; Conner *v.* Allen, 33 Ala. 516.

[7] Day *v.* Holmes, 103 Mass. 306.

has jurisdiction to afford relief to the pledgor by ordering a retransfer of the shares.[1] Where the pledgee undertakes to sell the pledge and to become the purchaser of it, he is regarded in equity as still holding it, in the character of a bailee and trustee under the original contract of pledge.[2]

§ 2679. Pledgee can Purchase at a Judicial Sale.— Although the pledgee cannot become a purchaser at his own sale where he sells without a decree of court,[3] the rule is otherwise where the sale takes place *under a decree of a court of equity;* for in such a case the pledgee is not himself the seller, but the sale is conducted by an officer of the court, usually by a master or commissioner; and therefore the reasons which disable him from being a buyer at his own sale do not exist.[4]

§ 2680. Sale of the Securities under a Decree of Court. — As already seen,[5] the pledgee may usually maintain a bill in equity to enforce his lien and secure a judicial sale of the securities in his hands, and this is often the safer course.[6] It has been held that, where the pledgor resides in a remote country or in a different State, and has no property subject to seizure or sale within the jurisdiction of the forum, these special circumstances will open the door of a court of equity to the pledgee.[7]

§ 2681. Obligation of Corporation to Transfer to Purchaser. — Where the sale has regularly taken place, in pursuance of the contract of pledge, or in pursuance of law, in the absence of express provisions in the contract, the corporation must transfer the shares to the purchaser on its books and issue

[1] Bryson *v.* Rayner, 25 Md. 424; *s. c.* 90 Am. Dec. 69; *ante*, § 2425, *et seq.*

[2] Bryson *v.* Rayner, *supra; ante*, § 2677.

[3] *Ante*, § 2677; Killian *v.* Hoffman, 6 Bradw. (Ill.) 200; Stokes *v.* Frazier, 72 Ill. 428; Richardson *v.* Mann, 30 La. An. 1060; Maryland &c. Ins. Co. *v.* Dalrymple, 25 Md. 242; Cal. Civ. Code, § 3010.

[4] See Newport Bridge Co. *v.* Douglas, 12 Bush (Ky.), 673, 720. As to pledgee's *right to possession*, see 79 Am. Dec. 499. Under the rules of the New York Stock Board, under consideration in a case decided in 1875, it seems that a pledgee of stocks had a right to purchase them at his own sale. See Quincy *v.* White, 63 N. Y. 370.

[5] *Ante*, § 2656.

[6] Stokes *v.* Frazier, 72 Ill. 428.

[7] Donahoe *v.* Gamble, 38 Cal. 340; *s. c.* 99 Am. Dec. 399.

to him a new certificate in the appropriate mode. But the corporation cannot be put in the wrong for refusing such a transfer where the pledgee has not sold at public auction after due notice to the pledgor, and has not resorted to a suit in equity as he may do.[1]

ARTICLE V. ACTIONS BY THE PLEDGOR FOR CONVERSION OF THE SHARES.

§ 2684. Tender of Amount Due by Pledgor not Necessary to Action. — Where shares of stock have been *converted* by a pledgee who holds them as collateral security for an amount due him by the pledgor, it is not necessary, in order to enable the pledgor to maintain an action for damages for the *conversion*, that he should first *tender* to the pledgee the amount due by him to the latter.[2]

§ 2685. But Pledgee may Recoup Such Indebtedness. — But in such a case the pledgee is entitled to *recoup* the damages by the amount of the debt that is due him by the pledgor.[3]

§ 2686. Pledgee may Show that the Transfers were Fictitious.— It has been held that the pledgee may show, as a defense to an action for the conversion of the shares, that the transfers of them made by him were fictitious, designed to conceal his transactions, and to prevent the injury to his credit which might follow from a publication of the fact of his having so many shares of the particular kind in his possession; and that all the stocks remained in his control and ready for delivery

[1] Indiana &c. R. Co. *v.* McKernan, 24 Ind. 62. As to the obligation of the corporation to issue new certificates to the pledgee, see Haldeman *v.* Hillsborough &c. R. Co., 2 Handy (Ohio), 101.

[2] Neiler *v.* Kelley, 69 Pa. St. 403, 409.

[3] Neiler *v.* Kelley, 69 Pa. St. 403, 409.

to the owner on the payment of the amount for which they were pledged.[1]

§ 2687. Pleading: Precedent of a Good Count in Trover for a Share Certificate. — A count in a declaration alleged that the defendant, intending to defraud the plaintiff of a quantity of manufacturing stock owned by him, induced him to assume certain pecuniary obligations, by promising to indorse his notes therefor when needed, without charge and without security, not intending to perform his promise; and that, when the plaintiff had assumed the obligations and needed the indorsement, the defendant refused to indorse unless the plaintiff's stock was delivered to him as security; and that the plaintiff, under the necessity,. transferred to him the stock to be held as such security; and that the plaintiff ultimately paid all the notes so indorsed and saved the defendant wholly harmless, and afterwards demanded of him a retransfer of the whole of the stock; but that the defendant returned but a part of the stock and retained and refused to return seventy-five shares of the same, claiming them, contrary to his promise, as compensation for his indorsement, and converted them to his own use. This was held to be a good count *in tort.* It contained all the essentials of a count in tort and also set out the elements of an actionable fraud.[2]

§ 2688. Another Precedent.— A count in a declaration alleging that the plaintiff transferred certain shares of stock to the defendant, as collateral security for indorsements made by defendant for him, and that it was the duty of the defendant to hold said stock for that purpose and to retransfer it to him when relieved of his liability as indorser; that the plaintiff had paid up all the paper so indorsed and had demanded a retransfer of the stock from the defendant, but that the defendant had refused to retransfer them and had converted them to his own use,—is likewise a good count *in tort*, under the theories of pleading in Connecticut for the *conversion* of corporate stock.[3]

§ 2689. Measure of Damages in Such Cases. — Where a broker had thus sold the stock of his principal, it was held that the principal was entitled to recover from him the *amount of profit* which he had realized from dealing with it.[4] According to another holding, where shares of stock are pledged to a broker to secure a note, with authority to him to sell the same on non-

[1] Day *v.* Holmes, 103 Mass. 306.

[2] Ayres *v.* French, 41 Conn. 142.

[3] Ayres *v.* French, 41 Conn. 142.

[4] Langton *v.* Waite, L. R. 6 Eq. 165.

payment, and are transferred to his name on the books of the corporation, with nothing to distinguish them from other shares owned by him, and, before maturity of the note, he sells or pledges and transfers shares standing in his name on the corporate books until he has left only a small fraction of the number pledged to him, at which time he is selling the shares at a price exceeding the market price before and afterwards,—the pledgor, in an action brought after maturity of the note, may recover the value of the shares disposed of, reckoned at that price, less the amount due on the note, after applying the proceeds of stock retained and sold after maturity, although the pledgee before maturity acquires sufficient shares to cover the number pledged.[1] Where shares had been pledged as collateral security for a debt, which was afterwards paid, but the shares nevertheless were allowed to stand in the name of the pledgee, and while so in his name were sold at auction for the non-payment of an assessment made thereon, and the pledgee himself became the purchaser,—it was held that the sale was invalid, and that the pledgor, in an action of trover therefor, was entitled to recover the *value* of the shares at the time of the alleged sale, and the *dividends* which the pledgee had received thereon, together with *interest*, after deducting the amount of the assessments and expenses of the sale.[2]

[1] Dykers *v.* Allen, 7 Hill (N. Y.), 497; *s. c.* 42 Am. Dec. 87.

[2] Freeman *v.* Harwood, 49 Me. 195.

CHAPTER XL.

OTHER DEALINGS IN SHARES.

ARTICLE I. DEALINGS WITH AND THROUGH BROKERS.

§ 2692. **View that the Relation between Broker and Customer is that of Pledgee and Pledgor.** — In New York the view has been taken that the ordinary contract for the speculative purchase of stocks, where the customer puts up "margins" in the hands of the broker to secure him against possible fluctuations in the market, makes the customer the *owner* of the stocks, and the broker a *pledgee* of them to secure his advances and commissions. In the leading case on this subject, the following propositions were ruled: "1. That the relation of broker and customer, under the ordinary contract for a speculative purchase

of stocks, is that of pledgee and pledgor. 2. That *sale* of the stock by the broker, under such a contract, without notice to the customer of the time and place of the sale, is a *conversion*. 3. That oral proof of the *usage* of brokers in such cases is not admissible to add to or make part of the contract."[1]

§ 2693. When Broker Purchasing for Customer may Resell for his Own Account.— This view of the relation of broker and customer does not obtain in Massachusetts. There, a broker who advances money to buy stock for another, and who holds the stock in his own name, may, if he has not been paid or tendered the amount of his advances according to the contract with his customer, *pledge* the stock as security for his own debt to a third person without making himself liable to an action by his customer; and this upon the ground that the contract was conditional, to deliver the shares to the customer upon the payment of the money.[2] And it can make no difference that a small portion of the money necessary for the original purchase was advanced by the customer. Accordingly, if a broker agrees to buy and hold certain shares of stock for a customer, and the customer pays part of the purchase price down, and agrees to pay interest on the broker's advances, and also to put up a certain margin in excess of the market price in the case of a depreciation in the market value of the shares, and the customer fails to perform his part of the contract by making such advances on demand, the stock having depreciated in value,— the broker may sell the stock at the brokers' board without notice to the customer, and will not be liable to him in an action for conversion.[3]

§ 2694. Whether Sale without Notice is Conversion.— In conformity with the former view it is held that a sale of the stock by the broker, under a speculative contract to purchase for his customer, without notice to the customer of the time and place of

[1] Markham *v.* Jaudon, 41 N. Y. 235; approved in Stenton *v.* Jerome, 54 N. Y. 480; reaffirmed by a divided court in Baker *v.* Drake, 66 N. Y. 519; *s. c.* 23 Am. Rep. 80.

[2] Wood *v.* Hayes, 15 Gray (Mass.), 375.

[3] Covell *v.* Loud, 135 Mass. 41; *s. c.* 46 Am. Rep. 446.

sale, is a conversion.[1] But where the view is taken that the relation between the customer and his broker is not that of principal and agent, the conclusion is that, on a contract whereby the broker agrees to buy and hold certain shares for his customer, who pays a part of the purchase price down and agrees to pay interest on the broker's advances, and also to pay in case of depreciation a certain margin in excess of the market price, the broker may sell the shares at the brokers' board without notice to the customer, after his failure upon demand to put up the required "margins."[2]

§ 2695. Right of Broker to Sell for Failure to Keep Good Margin.—Where a stock broker buys stock for a customer and carries it for him on what is known as a "margin," it is impliedly, if not expressly, agreed that the margin shall be kept good on demand; and upon failure of the customer so to do, the stock may be sold by the broker upon reasonable and customary notice,[3] or, as some courts hold, without notice.[4]

§ 2696. Right of Broker to Re-imbursement for Advances, Notwithstanding Sale Without Notice. — While in one view a sale without notice to the customer is a conversion of the shares by the broker, this fact does not of itself cut off the right of the broker to recover for his advances in respect of the purchase. If the customer has not in point of fact lost anything by the sale without notice, the broker is entitled to full indemnity. For instance, if the stock was sold at ninety and continued to depreciate and went down to fifty and remained there, it would follow that the customer lost nothing by the sale, provided that the shares brought the market value on the day of the sale. On the other hand the customer, sued by the broker, after such an unauthorized sale of the shares, may show by way of recoupment either that the shares brought less than the market price on the day of the sale, or that subsequently they advanced in

[1] Baker *v.* Drake, 66 N. Y. 518; *s. c.* 23 Am. Rep. 80 (Allen and Rapallo, JJ., dissenting).

[2] Covell *v.* Loud, 135 Mass. 41; *s. c.* 46 Am. Rep. 446.

[3] Gruman *v.* Smith, 81 N. Y. 25; reversing *s. c.* 12 Jones & Sp. 89; cited in Colt *v.* Owens, 90 N. Y. 368, 371.

[4] Covell *v.* Loud, 135 Mass. 43; *s. c.* 46 Am. Rep. 446.

price, and that he was entitled to a reasonable time after notice of the sale, provided such notice had been given, to replace the shares; for if, in the meantime, the shares advanced in price he would be entitled to the difference. Beyond this he could not have a recoupment of damages, for beyond this he would not be legally injured. The governing principle is that the customer cannot claim a greater benefit from his broker than would have accrued to him if the unauthorized sale had not been made.[1]

§ 2697. A Different Rule where the Shares have been Paid for.— A different rule arises where the shares have been purchased by the broker for his principal and paid for by the principal. In such a case it has been laid down that all fluctuations in price are at the risk of the vendor who refuses to deliver while retaining the purchase money.[2]

§ 2698. Broker Indemnified by Third Party.— The rule of damages above laid down holds, although the broker may have received an acceptable indemnity against loss, from a third party acting in the interest of his principal. Such an indemnity does not place the transaction upon the footing which it would occupy if the shares had been actually paid for with the money of the principal.[3]

§ 2699. Limits within which the Parties may make their Own Contract.— It is further held that the parties to such a transaction, which thus creates the relation of pledgor and pledgee between themselves, may provide by contract for any manner of disposing of the pledge to satisfy the claim upon it, — with the restriction, however, that the manner agreed upon must not be in contravention of a statute, nor against public policy, nor fraudulent.[4]

[1] Gruman *v.* Smith, 81 N. Y. 25; cited in Brewster *v.* Van Liew, 119 Ill. 554, 561; *s. c.* 59 Am. Rep. 823; and also in Ball *v.* Campbell, 30 Kan. 177.

[2] Baker *v.* Drake, 53 N. Y. 211, 217, 223; *s. c.* 13 Am. Rep. 507; Colt *v.* Owens, 90 N. Y. 368, 370.

[3] Colt *v.* Owens, 90 N. Y. 368; affirming *s. c.* 15 Jones & Sp. 430; cited in Brewster *v.* Van Liew, 119 Ill. 554, 561; *s. s.* 59 Am. Rep. 823. The rule of damages here referred to is that laid down in Baker *v.* Drake, 53 N. Y. 211; *s. c.* 13 Am. Rep. 507.

[4] Baker *v.* Drake, 66 N. Y. 518; *s. c.* 23 Am. Rep. 80, 84; citing Stenton *v.* Jerome, 54 N. Y. 480; Milliken *v.* Dehon, 27 N. Y. 364; Wheeler *v.* Newbould, 16 N. Y. 392.

§ 2700. Usage of Brokers.— Oral proof of the usage of the broker in such a case is not admissible to vary or make a part of the contract unless the customer has agreed with the broker to abide by such usage.[1] But the parties to such a contract may provide therein for any manner of disposing of the pledge to satisfy the claim which stands against it, which is not in contravention of a statute, against public policy, or fraudulent as against some other party. They may obviously agree that it shall be disposed of in accordance with the usages of the broker's office; and where they made such an agreement, and the customer brought an action against the broker for a conversion of the shares by an alleged sale of them without notice, and the broker offered to prove that it was the custom of his office to sell on account of the failure of a customer to furnish a sufficient "margin," at the stock exchange, without giving notice to the customer of the time and place of sale, it was held error to reject this offer.[2]

§ 2701. Usages of Stock Exchange Control only so Far as Reasonable. — Where a principal thus orders a broker to purchase certain stocks for him, and the stocks are not received and paid for, and the broker brings an action against him for the damages,— it will not always be sufficient for the broker to show that, in effecting the transaction, he did all that was usual and customary in the purchase and sale of stocks, and that he followed therein the due course of trade, and the custom of the particular business of buying and selling stocks on orders. Whether he will acquire a right of reclamation by doing all that is customary, depends, among other things, upon the *reasonableness of the custom*. If the custom sanctions a merely fictitious purchase, in which the broker actually advances no money, so that in point of fact he loses nothing, he will not have a right of reclamation against his principal, at least for the same damages which he could otherwise recover. The usage or custom of the particular business of buying and selling stocks on orders, in which the plaintiff is engaged, may be properly introduced, for the purpose of showing the manner in which the order he received from the

[1] Baker *v.* Drake, 66 N. Y. 518; *s. c.* 23 Am. Rep. 80.

[2] *Ibid.*, (three judges dissenting).

defendants may be performed, but not to imply an authority to execute it in a mode which the law would regard as unreasonable. "The order is given to a stock broker to purchase certain shares of a particular stock by parties not shown to have had actual knowledge of any peculiar usage or custom of his business; and while the law will allow custom and usage to regulate its execution in the reasonable mode we have indicated, it will not permit the defendants [the principals], by the force of any such custom or usage, to be bound by a merely fictitious purchase or sale; such, for instance, as one not *bona fide* and actually made, but pretended to be effected by mere entries upon books and accounts between the plaintiff and his New York agents."[1]

§ 2702. **Rights of Broker as against his Principal in Respect of Stock Purchased for the Latter, but not Received.**— Where an order is directed in general terms to a broker to purchase certain stock, but without specifying that the purchase is to be made in any particular place or mode, and without imposing any restrictions as to price, the broker has the right to make the purchase through correspondents, brokers, or subagents residing and doing business in a particular city, *e. g.*, New York City. But in order to acquire a right of reclamation against his principal in case the stock is not received by the latter, the broker must show that the stock was actually purchased under his directions or by his agents, at its fair market price on the day of purchase, and that he actually paid the purchase money therefor. Having thus made the purchase and expended his money, it is his duty to notify his principal of the fact and to request him to receive the stock and pay the price which the broker has paid for it, with usual and reasonable commissions for making the purchase. In an action against his principal for the damages which the broker has received by reason of the refusal of the former to receive the stock, the broker must show that, at the time of giving this notice, he was in a condition to deliver or transfer the stock, by having the certificates, or their proper *indicia* of title, actually in his hands, or in the

[1] Rosenstock *v.* Tormey, 32 Md. 169; *s. c.* 3 Am. Rep. 125, 128; quoting a passage from the opinion of Baron Cleasby in Maxted *v.* Paine, L. R. 4 Exch. 210.

hands of his agents, ready to be delivered or transferred to his principal. Upon receiving this notice it becomes the duty of the principal to pay for and receive the stock, and, on his failure so to do, the broker has a clear right, after a reasonable time, and after giving notice to that effect to his principal, to direct the stock to be sold in the city where it was purchased; and, upon showing, by legal and competent proof, that it was actually sold by his agents, either at public sale, in market overt, or at a sale publicly and fairly made at the stock exchange or stock board, or at a broker's board where such stocks are usually sold, at its fair market value on the day of sale,— he then becomes entitled to recover from his principal the amount, if any, of the resulting loss.[1]

§ **2703. Factor's Lien: Purchases for Agent of Unnamed Principal.**— A broker who purchases stock for another broker, who he has reason to believe is acting as agent, although for an unnamed principal, cannot hold the stock or its proceeds to secure the payment of a balance due him by such other broker. The reason is that one who has reason to know that the stock, when bought, belongs to another party, and has no reason to suppose that such other party is willing to have it used to pay the debts of his agents cannot, in good faith, so apply it; and it is wholly immaterial that he is not informed who the real owner is.[2]

ARTICLE II. "OPTIONS," "FUTURES," "STRADDLES."

§ **2706. Sales for Future Delivery: When Tender Good after Expiration of Time.**— Where a sale of stock is made for

[1] Rosenstock *v.* Tormey, 32 Md. 169; *s. c.* 3 Am. Rep. 125.

[2] Fisher *v.* Brown, 104 Mass. 259; *s. c.* 6 Am. Rep. 235. See also Shaw

future delivery, a tender of the shares, made after the expiration of the time, will be good if it was not contemplated by the agreement that they should be transferred on the precise date, and if the tender is not objected to on the ground of its being too late.[1]

§ 2707. Option Deals: Doctrine that no Purchase Need Actually be Made by the Broker. — The Supreme Court of Errors of Connecticut has let itself down to holding that a contract by which a broker agrees to buy and hold specified stocks on a margin account for his principal, who is to pay, as required, sufficient money to protect him from loss, the principal having the right to demand, at his option as to time, the delivery of shares at the price of the day of the agreement, does not require the broker actually to purchase shares and hold them indefinitely, locking up the necessary capital therein; and that where the shares have depreciated to the full extent of the margin paid, and the principal has ordered the sale of the shares, the fact that no purchase was actually made by the broker is immaterial, in an action by the principal against the broker for a conversion of the money advanced by him.[2]

§ 2708. Construction of an Option Expiring at the End of the Year. — Where the defendant had agreed to secure to the plaintiff a bid of a certain amount for the stock within a year, and, failing so to do, to take the stock from him at his option at the end of a year for a named sum,— it was held that it was not intended that the stock should be transferred on the precise day when the year expired; and where, on the evening of that

v. Spencer, 100 Mass. 382; *s. c.* 1 Am. Rep. 115; Bank of Metropolis *v.* New England Bank, 6 How. (U. S.) 212; Brandao *v.* Barnett, 1 Man. & Gr. 908; *s. c.* 6 *Id.* 630; 12 Cl. & Fin. 787; Fish *v.* Kempton, 7 C. B. 687.

[1] Duchemin *v.* Kendall, 149 Mass. 171; *s. c.* 21 N. E. Rep. 242. The court say: "It would be too strict and harsh a construction of the contract to hold that a technical common law tender *ad diem* was necessary in order to save the rights of the plaintiff. Generally when a party is to deliver a deed or other transfer upon the payment to him of money, it is enough if he offers, and is able to give, such deed or transfer, without making a formal tender." Citing Cook *v.* Doggett, 2 Allen (Mass.), 439; Thorndike *v.* Locke, 98 Mass. 340; Carpenter *v.* Holcomb, 105 Mass. 280.

[2] Ingraham *v.* Taylor, 58 Conn. 503; *s. c.* 18 Am. St. Rep. 291.

day, the plaintiff notified the defendant that he was expected to take the stock, and four or five days afterwards the plaintiff's agent called on the defendant and tendered him the stock, who refused to take it, but not on the ground that the tender was too late, the defense of a failure to make a tender was not available.[1]

§ 2709. Liability of Broker to Principal for Wrongfully Closing out a "Straddle."—In a case in New York, it appeared that the plaintiff, through the defendant, a stock broker, purchased what is known in the slang of the stock exchange as a "straddle," which is an option to demand of the seller, or to require him to take, at a stated price, a certain quantity of a specified stock, within a specified number of days. The plaintiff was induced to do this by a printed circular of the defendant, explaining the "straddle," offering himself to purchase his own selection, upon the payment of a specified sum, and guaranteeing that there would be a fluctuation to the extent of eight per cent. in the stock value during the time; or in default, offering to refund the amount, less his commission. The plaintiff accordingly authorized him to select and purchase for her. He did so, but, on the next day sold the stock "short" to her damage. It was held that these facts authorized a verdict in favor of the plaintiff for damages in an action founded on the theory of negligence.[2]

§ 2710. Construction of Statutes Enacted to Prevent Stock-Jobbing.—A statute of *Massachusetts* provides that every contract for the sale of stock shall be void unless the party contracting to sell the same is, at the time of making the contract, the owner or assignee thereof, or authorized by the owner or assignee, or by his agent, to sell the same.[3] The purpose of this statute was to prevent gambling in stocks. It does not, therefore, extend to a case where one who holds shares as a *naked trustee* for another enters into an agreement to assign shares at a future day.[4] Under this statute a contract for the transfer of shares in the

[1] Duchemin *v.* Kendall, 149 Mass. 171; 21 N. E. Rep. 242. *Other option contracts considered:*—Lien of brokers on securities purchased for their correspondents for advances: Willard *v.* White, 56 Hun (N. Y.), 581; *s. c.* 32 N. Y. St. Rep. 151; 10 N. Y. Supp. 170. A contract for the sale of shares of stock in a railroad corporation, at a specified price, "payable and deliverable, seller's option, in this year, with interest at the rate of six per cent. per annum,"—construed: Currie *v.* White, 45 N. Y. 822.

[2] Harris *v.* Tumbridge, 83 N. Y. 92; *s. c.* 38 Am. Rep. 398.

[3] Pub. Stat. Mass., chap. 78, § 6; Mass. Gen. Stat., ch. 105, § 6.

[4] Duchemin *v.* Kendall, 149 Mass. 171; *s. c.* 21 N. E. Rep. 242.

capital stock of a company incorporated under the laws of another State, by a person not the owner or assignee thereof, nor authorized by the owner, etc., to make such transfer, is void, notwithstanding that such person has previously, while acting as broker, sold such shares by mistake, and makes the contract for the purpose of indemnifying the owner.[1] - - - - A contract for the sale of any of the stocks enumerated in the statute of *New York*, relating to stock-jobbing, to be transferred at a future day, is absolutely void, if the party contracting for such sale and transfer, though in possession of the certificate or other evidence of the title to such stock, as required by the statute at the time of the contract, is then already under a liability or obligation for the sale or transfer of an equal or greater number of shares of the same stock.[2] The New York stock-jobbing act does not apply to sales of distributive shares in the effects of a corporation previously dissolved.[3]

§ 2711. Dealing Prohibited by Statute: When Purchaser not in Pari Delicto.— Where a law prohibits a cashier of a bank from dealing in stock, as the *Pennsylvania act of 1850*, it invalidates all his contracts contrary to its mandates. A party purchasing stock from a cashier stands *in pari delicto*, and cannot recover back the consideration paid. Otherwise, if the purchaser supposed he was purchasing from a cashier as the agent of a stockholder.[4]

Article III. Loans.

§ 2714. Loan of Shares Declared to be a Mutuum.— In dealings among brokers, shares of corporate stock are frequently loaned for two purposes: 1. Where a broker has sold particular stocks for future delivery and is called upon to make delivery in kind, instead of settling on the basis of "differ-

[1] Barrett *v.* Mead, 10 Allen (Mass.), 337.

[2] Stebbins *v.* Leowolf, 3 Cush. (Mass.), 137.

[3] James *v.* Woodruff, 10 Paige (N. Y.), 541.

[4] Burkholder *v.* Beetem, 65 Pa. St. 496.

ences" between the selling price and the market price at the time of delivery. 2. Where the parties desire to speculate in the rise or fall of particular stocks, and the holder, believing that they will rise in value, is willing to lend them to a solvent person, he paying the interest on the loan until the holder shall see fit to call for them; the borrower, on the other hand, believing that they will depreciate, intending to sell them on a falling market and to buy other stocks of the same kind at a lower rate in order to replace them, when called upon by the lender so to do. A lending of corporate stocks for the last-mentioned purpose has been classed with that kind of contracts which, in the language of the civil law, is denominated a *mutuum*. A *mutuum* "is a loan for use and consumption, the thing being bailed to be consumed, and an equivalent in kind subsequently returned."[1] In case of a loan, by way of *mutuum*, the borrower is bound to restore, at the time agreed upon, or within a reasonable period after request, an article of the same kind and quality as the one originally lent to him."[2] While the lending of corporate stocks for the purpose last mentioned is not strictly a *mutuum*, since the shares are not to be consumed in use, yet it is a *mutuum* in the sense that the particular shares may be sold by the borrower and he may discharge his obligation by returning the same number of shares of the same kind upon demand; in other words, he is not required to return the identical *certificates*.[3]

§ 2715. Illustration: Transaction Held to be in the Nature of a Mutuum.— G., owning shares of the Marietta & Cincinnati Railway Company, in 1856, transferred the same to F., who gave G. written obligations for their return, reciting substantially as follows: "Borrowed of W. G. 109 shares of Marietta & Cincinnati railroad stock, drawing interest at 8 per cent., to be returned on demand." Afterwards the Marietta and Cincinnati Railroad Company became insolvent; in 1860 a mortgage upon the road was foreclosed; all its property and rights were sold; the sale was affirmed and a deed made to the purchaser; and afterwards all its property, rights and franchises were conveyed to a new corporation, so that the old corporation ceased to exist in fact, and its stock from that time ceased to have any legal existence and became of

[1] Add. Contr. 347.
[2] *Ibid.* 468.
[3] Fosdick *v.* Greene, 27 Oh. St. 484; *s. c.* 22 Am. Rep. 328.

no value. It was held that the transaction was in the nature of a *mutuum*, and that payment in discharge of the loan could be made by a return of an equal number of shares of stock in the Marietta & Cincinnati Railway Company, without regard to its market value.[1]

§ 2716. Doctrine that the Lender Loses his Right of Action by Waiting until the Stock which he has Loaned has Become Extinguished. — In the case stated in the preceding paragraph, it was held that the lender of the stock had, by his laches, lost his right of action against the borrower, both as to the return of the stock and as to the recovery of pecuniary damages.[2] But the view of the court, though forcibly stated, does not seem to be sound. The case would seem rather that of a continuing trust or bailment, in which case the statute of limitations would not run, nor laches be imputable, until a repudiation of the trust relation by the bailee.

Article IV. Sales.

§ 2719. Whether Shares of Stock within the Statute of Frauds. — Although there is some conflict of decision on this question,[3] yet the tendency of American courts seems to be to

[1] Fosdick *v.* Greene, 27 Oh. St. 484; *s. c.* 22 Am. Rep. 328.

[2] Fosdick *v.* Greene, 27 Oh. St. 484; *s. c.* 22 Am. Rep. 328, 336, 339.

[3] See Somerby *v.* Buntin, 118 Mass. 279; *s. c.* 19 Am. Rep. 459; *ante*, § 1068.

hold that corporate shares are "goods, wares and merchandise," within that section of the statute of frauds which requires contracts for the sale of goods, wares and merchandise to be in writing unless accompanied by *delivery*.[1] Some of the courts likewise apply a liberal construction to the statutes against *fraudulent conveyances*, and hold that they extend to every species of property which is liable to be taken by legal process for the payment of debts, — construing the words "goods and chattels" as employed in the statute so as to include corporate stock and other choses in action.[2]

§ **2720. Motive of Purchase Immaterial.**— Parties who are interested in opposition to a corporation have the right to purchase its stock in order to defeat a contract which it is about to make.[3]

§ **2721. Purchases by Officers of Stockholders.**— While the officers of a corporation occupy, in a certain sense, a *fiduciary relation* to the stockholders, yet it has been held that a purchase of shares from a stockholder by an officer cannot be avoided on the ground of *fraud*, from the mere fact that the officer had knowledge in his official capacity of favorable sales of other stocks, which enhanced the value of the stock generally, of which fact the seller was ignorant.[4] This is in conformity with the view taken by the Supreme Court of Indiana, that the directors of a corporation are *trustees* for the stockholders only in respect of the management of the business of the corporation; and that when they undertake to deal with individual shareholders in the purchase of their shares they deal with them at arm's-length, as though no trust relation existed between them.[5]

[1] Tisdale *v.* Harris, 20 Pick. (Mass.) 9; Boardman *v.* Cutter, 128 Mass. 388.

[2] Sims *v.* Thomas, 12 Ad. & El. 536, 554; Barrack *v.* McCulloch, 3 Kay & J. 110; Stokoe *v.* Cowan, 29 Beav. 639; Pinkerton *v.* Manchester &c. R. Co., 42 N. H. 424, 457. This construction was criticised in Doyle *v.* Sleeper, 1 Dana (Ky.), 531, as being too elastic; but the Supreme Court of Rhode Island was inclined to think that the cases first above cited were rightly decided and that the statute of fraudulent conveyances of that State extended to fraudulent transfers of corporate stock. Beckwith *v.* Burrough, 14 R. I. 366; *s. c.* 51 Am. Dec. 392.

[3] Carson *v.* Iowa City Gaslight Co., 80 Iowa, 638; *s. c.* 45 N. W. Rep. 1068; *ante*, § 2303.

[4] Crowell *v.* Jackson, 23 Atl. Rep. 426; *s. c.* 53 N. J. L. 656.

[5] Board of Commissioners *v.* Rey-

The Supreme Court of New York took the same view of the question where one of the trustees of a corporation purchased of the plaintiff certain shares of its stock, and the action was brought to have the sale declared void and to have the contract rescinded on the ground of fraud and undue influence. It was held that the relation of *trustee* and *cestui que trust* did not exist.[1]

§ **2722. Whether Agreement to Purchase Construed to be at Par or Market Value.**—In the view of the Supreme Court of Georgia, an agreement to purchase stock of a corporation, without anything being said as to whether it is to be purchased at its par or market value, should be construed as an agreement to purchase at its *par value*.[2] But with more sense, the Kansas City Court of Appeals, of Missouri, held that where corporate stock is sold without any stipulated price, the law implies a promise to pay the *market value*, and in order that it should have a market value, it is not necessary it should be the subject of daily traffic; it is enough if it was occasionally the subject of sale or exchange in the community, so as to fix at different times a customary price.[3] It is believed that, as between individuals, the latter interpretation ought to prevail where the shares clearly have a market value, and that where they have no market value, then the contract ought to be construed like any other contract where the price is not named and there is no market value, as a contract to pay a fair price—what the thing is worth. But if the vendor is the corporation itself, disposing of its hitherto unissued shares, then, for reasons elsewhere given,[4] it should be held that the par value is intended.

§ **2723. Conditional Sales of Shares.**—Where a sale of stock of a corporation was made in consideration, in part, of a promise that the corporation would not set up any claim against the vendor of such

nolds, 44 Ind. 509, 516; *s. c.* 15 Am. Rep. 245.

[1] Carpenter *v.* Danforth, 52 Barb. (N. Y.) 581. As to when the purchase of the shares of one of the stockholders by the other two is a purchase for the two, and not for the corporation, see Schilling & Schneider Brewing Co. *v.* Schneider, 19 S. W. Rep. 67; *s. c.* 110 Mo. 83.

[2] Tilkey *v.* Augusta &c. R. Co., 83 Ga. 757; *s. c.* 10 S. E. Rep. 448.

[3] Deck *v.* Feld, 38 Mo. App. 674.

[4] *Ante,* § 1562, *et seq.*

stock, on account of past transactions, and, in violation of such stipulation, the company brought suit, it was held that such stipulation was not a condition on which the title of the stock depended, and that consequently, the title to such stock did not revert to the vendor.[1]

§ 2724. Measure of Damages for Failure to Deliver Shares.— Where the breach of a contract consists in the failure to deliver certain stock in a supposed corporation, the measure of damages will be the actual market value of such stock.[2] But if it turns out that the corporation was never formed and the stock never issued, and that if any were issued it would be valueless, the plaintiff can recover only *nominal damages.*[3]

§ 2725. Interpretation: Contract Held to be Executed and to Pass Title. — The following writing obligatory, "I hold of the stock of the Washington and Hope Railway Company $33,250, or 1,350 shares, which is sold to Paul F. Beardsley, and which, though standing in my name, belongs to him, subject to payment of $8,000 with interest at same rate, and from same date as interest on my purchase of Mr. Alderman's stock," has been held to be an executed contract, by which the ownership of the stock passed to Paul F. Beardsley, with a reservation of title, simply as security for the purchase money.[4]

§ 2726. Measure of Damages for Deceit Inducing Purchase of Shares. — In an action for inducing the plaintiff, by means of false and fraudulent representations, to purchase for value, corporate shares, which the defendant knew to be worthless, the proper measure of damages is the difference in value of the stock, as the condition of the company issuing it really was, from what the purchaser was fraudulently induced to believe it was. The market price of the stock about the time of, or after the purchase, is strong evidence of its value, and in the absence of other proof, will control. But where the real pecuniary condition of the company is shown, from which it appears the stocks were worthless, such market price is entitled to no weight upon the question of value. The purchaser, after dis-

[1] Jackson *v.* Grant, 18 N. J. Eq. 145.

[2] Deck *v.* Feld, 38 Mo. App. 674.

[3] Gibson *v.* Whip Publishing Co., 28 Mo. App. 450.

[4] Beardsley *v.* Beardsley, 138 U. S. 262; *s. c.* 34 L. ed. 928; 11 Sup. Ct. Rep. 318.

covery of their worthlessness, is not bound to mitigate the loss of him by whose fraud he was induced to purchase, by himself cheating some ignorant purchaser.[1]

§ 2727. **Market Price of Stock on a Given Day.** — Under a reference to ascertain the market price of a certain stock on a given day, the intrinsic value of the stock should not enter into the estimate, unless there has been no market price within a reasonable period, either before or after that day. It is not material to inquire why the stock appeared in the market, when it was not thrown on the market in large quantities.[2]

§ 2728. **Specific Performance of Contract for Sale of Shares.**— As a general rule, equity will not decree the specific performance of an executory contract for the *sale* of personal property.[3] An exception to the rule is admitted where the subject-matter of the sale is something which possesses a *pretium affectionis*, or where for some reason, the purchaser could not have declined relief in an action at law for damages. This principle applies to sales of shares of corporate stock; and the general rule is that equity will not enforce specific performance of such contracts. But it has nevertheless been held that where a purchaser has bargained for or taken an option upon such shares, because they have to him an unique or special value, the loss of which could not be adequately compensated by an action at law, the chancellor, in the exercise of *a sound discretion*, may decree specific performance.[4]

[1] Hubbell *v.* Meigs, 50 N. Y. 480.

[2] Douglas *v.* Merceles, 25 N. J. Eq. 144.

[3] Fry Spec. Perform. (Am. ed. 1884), § 56; 3d Eng. ed. 1892, §§ 66, 78; Pomeroy Spec. Perform., § 47; Madison *v.* Chinn, 3 J. J. Marsh. 230.

[4] Reasoning in Bumgardner *v.* Leavitt, 35 W. Va. 194; *s. c.* 12 L. R. A. 776; 9 Rail. & Corp. L. J. 430; 13 S. E. Rep. 67. See also Chater *v.* San Francisco Sugar Refining Co., 19 Cal. 219; Treasurer *v.* Commercial Gold Mining Co., 23 Cal. 392; Baldwin *v.* Com., 11 Bush (Ky.), 417; Todd *v.* Taft, 7 Allen (Mass.), 371; Johnson *v.* Brooks, 93 N. Y. 337; Cushman *v.* Thayer Man. &c. Co., 76 N. Y. 368; *s. c.* 32 Am. Rep. 315; White *v.* Schuyler, 31 How. Pr. (N. Y.) 38; Ashe *v.* Johnson, 2 Jones Eq. (N. C.) 140; Cheale *v.* Kenward, 3 De Gex & J. 27; Duncuft *v.* Albrecht, 12 Sim. 189; Cowles *v.* Whitman, 10 Conn. 121; *s. c.* 25 Am. Dec. 60; Draper *v.* Stone, 71 Me. 175; Leach *v.* Fobes, 11 Gray (Mass.), 506; *s. c.* 71 Am. Dec. 732; Bissell *v.* Michigan &c. Bank, 5 McLean (U. S.), 495; Doloret *v.* Rothschild, 1 Sim & Stu. 590.

§ 2729. When Equity will Grant Relief to the Vendor.— There is more difficulty in discovering any tenable ground, consistent with the theory upon which courts of equity proceed in granting this species of extraordinary relief, upon which the vendor can claim a specific performance of the contract; since a specific performance at his suit turns the action into a mere action for the collection of the purchase money. Nevertheless, it is sought to sustain this jurisdiction upon the theory of *mutuality;* and the theory seems to be to consider whether, under the circumstances of the case, the vendee would be entitled to a specific performance if he should seek it, and then to award specific performance in favor of the vendor, on the theory that where the right to specific performance exists at all, it must be mutual and that the remedy must be alike accessible to both parties.[1]

§ 2730. Circumstances under which Specific Performance not Decreed.— Specific performance of a contract of this kind will not be decreed except upon *clear and satisfactory evidence.* This, indeed, is an elementary rule with reference to the specific performance of contracts.[2] Such relief has been refused in the case of an alleged sale of mining shares, where the complainant had taken no steps to preserve the evidence of the execution of the contract, or of its terms, and sought to enforce the contract after the death of the other contracting party.[3] Specific performance of a contract by a railroad company to transfer bonds and stocks to a construction contractor in payment for the work and materials done and furnished by him in excess of payments will not be decreed where heavy obligations created by him are outstanding against the company, and the stock and bonds have confessedly no market value.[4]

§ 2731. Interpretation of Contract of Sale Reserving "all Profits and Dividends."— The plaintiff entered into a contract with the defendant by which he agreed to exchange with defendant, at the

[1] Bumgardner *v.* Leavitt, 35 W. Va. 194; *s. c.* 12 L. R. A. 776. See also Walker *v.* Bartlett, 2 Jur. (N. S.) 643; Paine *v.* Hutchinson, L. R. 3 Eq. 257; Duvell *v.* Myers, 2 Md. Ch. 401; Moore *v.* Fitz Randolph, 6 Leigh (Va.), 175; *s. c.* 29 Am. Dec. 208; Pomeroy Spec. Performance, § 165.

[2] Knoll *v.* Harvey, 19 Wis. 99.

[3] Hibbert *v.* Mackinnon, 79 Wis. 673; *s. c.* 49 N. W. Rep. 21. See in illustration of the principle, Ryder *v.* Bushwick R. Co., 32 N. Y. St. Rep. 1105; *s. c.* 10 N. Y. Supp. 748.

[4] Wood *v.* Boney (N. J.), 21 Atl. Rep. 574.

option of the latter, twenty shares of stock in a certain corporation, for ten shares in another corporation,— the defendant agreeing that, in case he should elect to make the exchange and the same should be made, "all *profits* and *dividends* of and upon such stock up to the first day of January, 1872, should be paid to the defendant." The exchange was effected in pursuance of the contract. No dividends were declared on the stock, nor was any distribution of profits made or paid by the company, after the making of the contract, and prior to January 1st, 1872. In an *action to recover a dividend* made on the 9th of April, 1872, it was held that the plaintiff was not entitled to recover any portion of it, although it was found as a fact that a part of it was earned prior to January.[1] This is in pursuance of what was said in a former case in the same court: "When, therefore, a contract is made in relation to dividends or profits, it must be deemed to have reference to dividends or profits to be ascertained and declared by the particular company, and not to growing profits from day to day, or month to month, to be ascertained upon an investigation by third persons, or a court of justice, into the accounts and transactions of the company."[2]

§ **2732. Sale or Executory Agreement.** — Defendant gave plaintiff his note for the purchase price of some railroad stock, plaintiff giving back a bill of sale, in which it was recited that the stock had been transferred to defendant, but that plaintiff was to hold the same for the payment of the note, and that plaintiff would deliver the stock, specifying the particular certificates, upon such payment. In an action on the note, it was held that the transaction was a sale and not an executory agreement, and plaintiff was not bound to tender the stock or make any formal transfer thereof on the books of the railroad company until payment or tender thereof by defendant.[3]

§ **2733. Various Decisions Touching Sales of Shares.**— Where there has been a sale of stock, and the buyer has paid par value and also a *pro rata* portion of an anticipated dividend, if it turns out that no dividend has been earned, he may recover back so much of the purchase price as was paid for the anticipated dividend.[4] - - - -

[1] Hyatt *v.* Allen, 56 N. Y. 553; *s. c.* 15 Am. Rep. 449.

[2] Clapp *v.* Astor, 2 Edw. Ch. (N. Y.) 379. Compare Re Barton's Trust, L. R. 5 Eq. 238; *ante*, § 2172.

[3] James *v.* Hamilton, 5 Thomp. & C. (N. Y.) 183; *s. c.* 2 Hun (N. Y.), 630. For another state of facts on which it was held that the agreement to sell was merely executory, and would not be specifically enforced after the lapse of sixty years, see Moss' Appeal, 43 Pa. St. 23.

[4] Riggs *v.* Tayloe, 2 Cranch C. C. (U. S.) 687.

Upon an agreement that there should be a fair examination of the affairs of a corporation, with reference to the question of the value of the stock, and that one owner should sell out his shares to the others at a price based upon the result of that examination, the seller is entitled to relief, upon proof of *fraudulent practices* upon him in the examination.[1] - - - - A. agreed to sell certain shares of stock to S., who delivered in payment therefor a draft on P., to whom A. gave up the draft on receipt of G.'s check on a bank. The bank refused to pay the check, and A. declined to transfer the stock, and did not tender back the check to S. until the trial of an action for the non-delivery. Here, as the shares had been paid for, the action for non-delivery was maintainable.[2] - - - - Certain stock in a company was sold at par. A note was given for the price payable out of the net receipts or earnings of the stock, to be paid quarterly by the company. The note contained a condition that the principal should become due upon failure to pay the installments regularly. This transaction, by which the stock was to pay for itself, so to speak, was a valid sale under the circumstances, the shares having been delivered.[3] - - - - Where the vendee of shares gave his note for the purchase money, and to secure the note mortgaged his interest in the company, the equity of redemption was not extinguished by proceedings to foreclose the same, taken during the *war* of 1861–1865, within the Union lines, whilst the defendants were in the Confederate lines, and communication between the two was nearly impossible.[4] - - - - A purchase of all the corporate stock, by two persons jointly, does not render them joint tenants, tenants in common, nor partners. They become or remain corporators.[5] - - - - Where a person was entitled to shares in an incorporated company, on his performing certain acts for them, and where the company did not set up any want of complete performance of the condition as a ground of forfeiture, but conducted in the matter as if full performance had been made, and such person conveyed certain of his shares to a third person, it was not competent for the latter to set up such a condition to avoid his own contract in the purchase.[6] - - - - Where A. transferred to B. stock in a turnpike company, which, at the time of the transfer, appeared by the books of the company to have been fully paid up, by a credit of interest on the amount before paid, in pursuance of a resolution of the directors, and this resolution was, after the transfer, repealed, and the stockholders

[1] Hager *v.* Thomson, 1 Black (U. S.), 80.

[2] Sears *v.* Ames, 117 Mass. 413.

[3] Dean *v.* Nelson, 10 Wall. (U. S.) 158.

[4] Dean *v.* Nelson, 10 Wall. (U. S.) 158.

[5] Russell *v.* McLellan, 14 Pick. (Mass.) 63.

[6] Bradley *v.* Chase, 22 Me. 511.

called upon to pay in the amount before allowed for interest, in consequence of which B. paid to the company that sum on the shares transferred to him by A., it was held that B. could not maintain an action to recover the amount from A., there being neither fraud nor warranty.[1] - - - - In Louisiana, where property incumbered with a mortgage to secure the subscription of a shareholder to the capital stock of a corporation, is sold with the shares of stock, for a certain price, and without guaranty against the mortgage, the purchaser is liable to the original stockholder, who, when called on for payment of the subscription, may call in warranty his vendee, although there had never been any transfer of the stock on the books of the company.[2] - - - - Shares of stock being, in one conception, "goods, wares and merchandise" within the statute of frauds,[3] an executory verbal contract to sell them is void,[4] and a release from such a contract has been held an insufficient consideration to support a promise by the releasee to pay a sum of money.[5]

Article V. Warranties.

§ 2737. Express Warranty in the Sale of Shares.— A warranty by the seller of corporate stock, that no assessments are about to be made, is not broken by the fact that shortly after the sale the stockholders by agreement issue new stock to be purchased by themselves, the proceeds to be applied in payment of debts.[6]

§ 2738. No Implied Warranty that Directors will Accept Purchaser. — As already seen,[7] the governing instrument of the corporation in some cases vests in the directors the power to

[1] Cunningham *v.* Spier, 13 Johns. (N. Y.) 392.

[2] Clinton &c. R. Co. *v.* Eason, 14 La. An. 828.

[3] *Ante*, § 1068.

[4] Tisdale *v.* Harris, 20 Pick. (Mass.) 9.

[5] North *v.* Forest, 15 Conn. 400.

[6] Humphrey *v.* Merriam, 46 Minn. 413; *s. c.* 49 N. W. Rep. 199.

[7] *Ante*, § 2320.

refuse to admit a transferee to membership. This is more frequently the case in respect of English companies. It has been held that a contract whereby shares are sold according to the rules of the London stock exchange does not import an undertaking by the vendor that the company will register the transferee; so that if the directors decline to register him the transferee has no action for damages against the transferor.[1]

§ 2739. No Implied Warranty that the Corporation is a Corporation de Jure.— It has been held that the law does not imply a warranty on the part of the vendor of certificates of stock that the corporation issuing them is a corporation *de jure;* but that if the corporation is authorized by an existing statute and is otherwise a corporation *de facto*, that is sufficient to relieve him under the theory of an implied warranty.[2]

§ 2740. No Implied Warranty Against Fraudulent Over-Issues.— It has been held that, while the vendor of shares of stock impliedly warrants that the certificate is issued by the duly constituted officers of the company and is sealed with the genuine seal of the corporation,— that is to say, he impliedly warrants that it is *no forgery*,— yet that he does not impliedly warrant that such shares have not been fraudulently issued by the officers of the corporation in excess of its charter limit; and that if such proves to be the case, the vendee has no recourse against him.[3] This decision proceeds upon the principle, already stated, that although in such a case the purchaser of fraudulent shares is not entitled to the rights of the shareholder, yet the fraudulently issued certificate so far operates in his hands as an *estoppel* against the corporation as to prevent them from resisting his action to be *indemnified* in respect of what he has *lost* by reason of purchasing or advancing money on the faith of the same.[4]

[1] Stray *v.* Russell, 1 El. & El. 888, 917; London Founder's Assoc. *v.* Clarke, 20 Q. B. Div. 576; *s. c.* 57 L. J. (Q. B.) 291; 59 L. T. (N. S.) 93; 36 Week. Rep. 489.

[2] Harter *v.* Eltzroth, 111 Ind. 159, 161.

[3] People's Bank *v.* Kurtz, 99 Pa. St. 344; *s. c.* 44 Am. Rep. 112. See to the same effect, Seiser *v.* Mali, 41 N. Y. 619; reversing *s. c.* 32 Barb. (N. Y.) 76. Compare State *v.* North Louisiana &c. R. Co., 34 La. An. 947.

[4] It was upon this ground that Taft,

§ **2741. A Contrary View.** — It has been held by Taft, J., in the Superior Court of Cincinnati, in an elaborate opinion, that in a sale of spurious corporate stock certificates by an innocent vendor to an innocent vendee, there is an implied warranty of *genuineness*, and the vendor is liable for its breach.[1] A little reflection will disclose that this holding involves an exceedingly close question. A careful discrimination must be made between the sale of pretended shares which are evidenced by certificates which are spurious, in the sense in which forged or fraudulent certificates are spurious, and the case of the sale of shares of a well-known series which may turn out to have been issued without authority on the part of the officers of the corporation to issue them. Mr. Benjamin, in discussing the principle, says: "Under this head may also properly be included the class of cases in which it has been held that a vendor who sells bills of exchange, notes, shares, certificates and other securities, is bound, not by the collateral contract of warranty, but by the principal contract itself, to deliver, as a condition precedent, that which is genuine, and not that which is false, counterfeit, or not marketable by the name or denomination used in describing it."[2] The cases cited by Benjamin in support of this passage were not all of them cases involving forgeries, though several of them were cases of that character.[3] Among the cases which he thus cites is one where the subject of sale was four bonds of the government of Guatemala. The bonds delivered under the contract were bonds which had been issued by that government, but which were not marketable or valuable, because the gov-

J., in a case about to be considered, undertook to distinguish this case from the case which he had under consideration in Cincinnati &c. R. Co. *v.* Citizens' Nat. Bank, 24 Oh. L. J. 198, 211. In the case at bar he said: "The certificates, while properly signed by the duly constituted officers, were not issued by them. The *ratio decidendi* of the Kurtz case is that the vendor of the certificates in question there, which were fraudulently issued, transferred to the vendee a chose in action giving to the vendee exactly the same remedy and amount of recovery against the company as if the stock had been genuine and the transfer had been refused by the company. It has already been held in this case that no recovery can be had against the railway company on these certificates. This fact makes the Kurtz case inapplicable here."

[1] Cincinnati &c. R. Co. *v.* Citizen's Nat. Bank, 24 Oh. L. J. 198.

[2] Benjamin on Sales, Ben. Ed. 1888, § 607.

[3] Jones *v.* Ryde, 5 Taunt. 488; Westropp *v.* Solomon, 8 C. B. 345; Gurney *v.* Womersley, 4 El. & Bl. 133.

ernment had, after their issue, repudiated all of its bonds which were unstamped, as these were. Although both parties to the sale were ignorant of this repudiation, it was held that the price of the bonds could be recovered. The reasoning of Tindal, C. J., was that the contract was for real Guatemala bonds, and that the case was the same as if the contract had been to sell foreign coin and the defendant had delivered counters instead. "It is not," said he, "a question of warranty, but whether the defendant has not delivered something which, though resembling the article contracted to be sold, is of no value."[1] Another case in illustration of the same doctrine was a case where the subject of the sale was what purported on its face to be a foreign bill of exchange, and which, therefore, *prima facie*, required no stamp in order to its validity under the English stamp laws. But it turned out that the bill was really drawn in England, and, being unstamped, it was hence worthless. It was held that the purchaser was entitled to recover back the price, because the thing sold was not of the kind described in the contract of sale,— that is, was not really a foreign bill of exchange.[2] The principle on which the English courts thus proceed is closely analogous to a principle already considered, under which a party enters into a contract to take shares in a given venture, — that is, in a corporation organized for certain objects or having a certain capital,— and when it comes to the execution of the contract, he finds that it involves an attempt to impose upon him shares of a different nature, that is, shares in a corporation organized for different objects or having a different capital. In such cases, as he contracted to become the purchaser of one thing, he cannot be compelled to become the purchaser of another thing. In other words, the law cannot make for him a different contract from that to which he himself consented.[3] Judge Taft, after going carefully over these and other decisions, came to the conclusion that the principle involved in them is applicable to the case where a corporation, having issued all the shares which it could issue under its governing statute and articles, other share

[1] Young *v.* Cole, 3 Bing. (N. C.) 724.

[2] Gompertz *v.* Bartlett, 2 El. & Bl. 849.

[3] *Ante*, § 66, *et seq.*, and § 1267, *et seq.*

certificates, signed in blank by the president and sealed with the corporate seal and left with the secretary for use in executing transfers, were fraudulently issued by him and pledged as collateral security for his own ends. The learned Judge held that, in the case of an assignment of a certificate, representing such spurious shares, there was an implied warranty that the certificate represented genuine shares; in other words, the thing intended to be transferred was not the particular piece of paper, but genuine shares of the particular corporation; and he pointed out that the American theory proceeds upon an *implied warranty of identity*, while the English theory, reaching the same result, proceeds upon a condition of the principal contract, that one thing has been bargained for and another delivered.[1]

§ 2742. Cases to Which the Foregoing Principle does not Apply.— The foregoing principle does not apply to a case where *both parties know what they are contracting for*, although the thing turns out to be, in regard of its validity, different from what both parties expected. There may be very great difficulty in distinguishing the two classes of cases, and possibly they are not distinguishable on any very strict principle. But, in illustration of this attempted distinction, we may take an English case where the subject of the sale was "Kentish Coast Railway Scrip." The scrip delivered, in pursuance of the contract of sale, was scrip which had been sold in the market by that name for several months. There was no scrip of that name in existence. The company had been organized; allotments of its stock had been made; money had been deposited under such allotments, and scrip certificates had been issued by the secretary to represent them. After several months, during which the certificates had been generally dealt in in the market, the directors declared that the issue of the certificates was in excess of the authority of the secretary. An action was brought by the purchaser against his vendor to recover on the theory of an implied warranty that the secretary had authority to issue the certificates. But the Court of Exchequer decided that the question was whether, when the parties contracted for a sale of "Kentish

[1] Cincinnati &c. R. Co. *v.* Citizen's Nat. Bank, 24 Oh. L. J. 198, 210.

Railway Scrip,'' they meant the scrip then on the market and the scrip which was actually delivered, which question was a *question for the jury.* The court also intimated that the contract had probably been complied with, because no other scrip of the kind was on the market. The principle on which the case proceeded was that the parties had contracted for the kind of scrip which was being sold on the market under that designation, without reference to its character. So far as they were concerned, the scrip was genuine, because it was with reference to that scrip that their contract had been made.[1] On the same principle, where *municipal bonds* are issued payable to a party named or to the bearer, and such bonds, properly executed, are put upon the market and sold, and it afterwards is judicially determined that the legislature had no power to pass the statute under which they were issued, one who purchases them from another equally innocent with himself, cannot recover the purchase money, on the ground of a failure of consideration.[2]

Article VI. Other Dealings.

§ **2746. Law of the Place.**—It has been held, in a controversy touching the validity of a transfer of share certificates in England, that the question whether a bank which had taken such shares from a fraudulent broker as pledgee for a loan to him was to be

[1] Lambert *v.* Heath, 15 Mees. & W. 486.

[2] Otis *v.* Cullum, 92 U. S. 447, 449. See also Ætna Life Ins. Co. *v.* Middleport, 124 U. S. 534.

deemed to be rightfully in possession of them, was to be decided in conformity with the English law, as the transaction took place in England, although the consequences of being rightfully in possession of them might be determined by the American law.[1]

§ 2747. Reduction by Husband of Wife's Shares into his Possession.—From the doctrine that shares of stock are personal property, it would follow that, upon a marriage without a settlement, the shares owned by a wife would at common law vest in the husband, so as to entitle him to reduce them into his possession. But it is a principle that a merely fiduciary possession, by a husband of his wife's property, can not be considered such a reduction into possession as will entitle his representatives, on his death, to such property to the exclusion of the surviving wife;[2] and upon the same principle it has been held that the shares of stock belonging to a married woman are not reduced into her husband's possession, so as to become vested in him by a transfer of them to him as a trustee; since the transfer was made *diverso intuito*.[3]

§ 2748. What Acts Indicate a Purpose on the Part of Husband not to Reduce Wife's Shares into his Possession.—Previous to her marriage a wife held certain shares of stock in an incorporated company, the profits of which the husband received until the charter expired, at which time the stockholders were entitled to subscribe a portion of their shares in a new bank. He subscribed the authorized amount in the name of his wife, and refused to receive the balance in money, saying that it was not his, but his wife's. After his decease, his executors received this balance, and the dividends and profits on the shares, and also a sum payable on account of the reduction of the capital of the bank. It was held that the husband had, by these acts, indicated a plain intention not to reduce the shares into his possession, and that the widow was entitled to recover of his executors the sum so received, with interest.[4]

[1] Williams *v.* Colonial Bank, 38 Ch. Div. 388; *s. c.* 57 L. J. Ch. D. 826; 59 L. T. (N. S.) 643; 36 Week. Rep. 625.

[2] Baker *v.* Hall, 12 Ves. 501.

[3] Wall *v.* Tomlinson, 16 Ves. 413.

[4] Stanwood *v.* Stanwood, 17 Mass. 57.

§ 2749. Assignment by Married Woman in Pledge to Secure Debt of Husband.— In New Jersey, while it is settled that a married woman may not bind herself by her promise to pay the debt of another, yet it has been held that where a married woman has transferred to another person shares of corporate stock in pledge to secure the debt of her husband, and the transfer has been made upon the books of the company, and has been repeatedly recognized by her in the form of petitions for leave to vote at corporate elections in respect of it,— it will not be undone at her suit.[1]

§ 2750. Apportionment as between Legatees.— Where a testator, who is a partner in a quarry company, wills his property, real and personal, to his widow and daughter in certain proportions, and the property is allowed to remain in the business, and afterwards a corporation is formed, the partners taking stock to the extent of their respective interests in the partnership, the proportionate interests of the widow and daughter are not changed by the varying quantities of personal and real estate held by the partnership at different times, or by the quantity of each at the time the corporation succeeded the partnership; and the stock in the corporation representing the joint interests of the widow and daughter should be apportioned between them according to their interests at the death of the testator.[2]

§ 2751. Shares held by a Partnership: Effect of Succession in the Firm.— Where a firm holds stock in a corporation, and one of its members dies, the survivor has power to represent the stock in all corporate proceedings. If a new firm is created by the admission of a new partner after the death of an old one, and the stock becomes part of the assets of the new firm, the new partner will possess all the powers of a partner in reference to the stock.[3]

§ 2752. Sale by Heir no Estoppel against Him as Administrator.— It is familiar law that, upon the death of a person, his

[1] Walker *v.* Joseph Dixon Crucible Co., 47 N. J. Eq. 342; *s. c.* 20 Atl. Rep. 885.

[2] Hotchkiss *v.* Brainerd Quarry Co., 58 Conn. 120.

[3] Kenton Furnace Co. *v.* McAlpin, 5 Fed. Rep. 737, 749.

personal property does not, *ipso facto*, vest in his heirs or in his next of kin without the intervention of an executor or administrator and a distribution under the orders of a court of probate, or other court having jurisdiction to administer the property of the estate. If an heir gets possession of the personal property of his ancestor without the intervention of the executor or administrator and a formal distribution, he is regarded in the law merely as a wrong-doer and is called an *executor de son tort*. He has no title which he can transfer to a purchaser. If he is subsequently appointed an administrator, he acquires it *in trust*, first for the creditors, and secondly for those who, under the statute of distributions, are entitled as distributees after the payment of the debts. In other words, he holds his title in the right of others, and not in the same character in which he would have held it prior to his appointment had the legal title been in him. It has, therefore, been held, upon such consideration, that he is *not*, after being appointed administrator, *estopped* by a previous unlawful and unauthorized sale made by him, of personal property of the estate, from suing for and recovering the same in his representative character; [1] and this rule holds in respect of shares of corporate stock equally with other personal property.[2]

§ 2753. Liability for Intermediate Assessments in Case of a Sale with an Option to Re-Purchase.— If the holder of shares sells them out and out for a round sum, but takes an agreement from his vendee which gives him an option to repurchase them at any time prior to a date named, for a stated sum, together with all assessments made after the contract; and thereafter, before the expiration of this option, *voluntarily* pays an assessment laid against the shares, and then declines to exercise his option to take them back, — he cannot, it has been held, recover from his vendee the assessment so paid. It was regarded as a voluntary payment made by him in contemplation of the existence of his option to repossess himself of the shares, and, as it was not made at the instance or request of the vendee, the law did not raise any promise on his part to repay the amount

[1] Cullen *v.* O'Hara, 4 Mich. 132.

[2] Morton *v.* Preston, 18 Mich. 60, 69; *s. c.* 100 Am. Dec. 146.

to his vendor.[1] The question seems to have been a close one; and while the case was probably decided in conformity with strict legal principles, the result was plainly inequitable, and the case might probably have been decided the other way upon good and sufficient reasons.

§ 2754. When Stockholder Estopped from Impeaching Validity of Shares.— A stockholder in a corporation will not be allowed to deny the validity of shares, issued by the corporation in consideration of the acquisition of property from another corporation, so long as it retains the property.[2]

§ 2755. Effect of By-law Giving to Other Stockholders a Right of Pre-emption.— A requirement in the by-laws of a corporation, that before a sale of its stock the holders thereof shall offer it in writing through the treasurer to the then existing stockholders, is solely for the benefit of such then existing stockholders, and they alone are entitled to object on the ground of any non-compliance therewith. In such a case it will be *presumed*, from the fact that a corporation permitted transfers to be made, that a requirement in its by-laws that stockholders, before selling their stock, shall offer it in writing through the treasurer to the then existing stockholders, was waived, or that an offer was made and declined, especially where ten years have elapsed without any objections to the sales or claims to the stock having been made.[3]

§ 2756. Particular Contracts Relating to Corporate Shares Construed.— The plaintiff's intestate subscribed $30,000 to the capital stock of a transportation company, and made part payment of the subscription by the sale of a steamboat to the company for $19,000. Fearing that he might not be able to pay the remainder when called upon, it was agreed between himself and C., who was largely interested in forming the company, that in the event that he could not respond to

[1] Treadway *v.* Johnson, 33 Mo. App. 122. The court cited and relied on Gavinzel *v.* Crump, 22 Wall. (U. S.) 308, which was a transaction in Confederate notes.

[2] Buford *v.* Keokuk Northern Line Packet Co., 69 Mo. 611; affirming on the opinion of the court below, *s. c.* 3 Mo. App. 159.

[3] American Nat. Bank *v.* Oriental Mills, 17 R. I. 551; *s. c.* 11 Rail. & Corp. L. J. 206; 23 Atl. Rep. 795.

further calls, C. would take the $11,000 stock off his hands. The company decided to increase its transportation facilities, and the decedent was unable to meet further calls on stock made in consequence. The court held that C. was bound to take the stock, and that, having refused to do so, and the stock having been sold, he was liable for the difference between its par value and the amount it sold for.[1]

[1] Lewis *v.* Coates, 93 Mo. 170; *s. c.* 5 S. W. Rep. 897. *Fraudulent conveyances of shares.*—State of facts under which conveyances of the paid-up shares of the stockholders of a corporation and also a deed conveying the corporate property to its president were held not fraudulent as to a creditor: Parke County Coal Co. *v.* Terre Haute Paper Co., 26 N. E. Rep. 884. Construction of a contract under which three persons form a corporation, two paying their shares in cash and the third giving his note and pledging his stock as security, under which, although the note was not made, nor the stock issued, he was held to be as against the others a shareholder, they having waived their formal rights against him: Chater *v.* San Francisco &c. Co., 19 Cal. 219. Construction of a contract by which one party agrees to deliver certain shares to the other party on or before a future date in consideration of a conveyance of property by the other party: Faulkner *v.* Hebard, 26 Vt. 542. Construction of a contract with a servant of the corporation by which he was to receive a *pro rata* of a certain number of shares for his services in case he should "die *or leave* the corporation"— holding that his *dismissal* was not a leaving, and that he was entitled to the full amount: Price *v.* Minot, 107 Mass. 49. Rulings in an action on a contract to *assign and transfer* stock subscriptions: Rand *v.* Wiley, 70 Iowa, 110; *s. c.* 29 N. W. Rep. 814.

CHAPTER XLI.

EXECUTION AND ATTACHMENT AGAINST SHARES.

ARTICLE I. IN GENERAL.

§ 2765. Shares of Corporate Stock Subject to Execution and Attachment. — While it was the rule of the common law that an execution could not be levied upon shares of stock in a corporation, unless the officer could get possession of the certificate in the hands of the shareholder, which might be seized just as a note, bill, or other chose in action might be,[1] yet statutes

[1] Foster *v.* Potter, 37 Mo. 525; *post*, § 2788; *ante*, § 1072.

now exist, it is supposed, in all the States, providing that writs of *fieri facias* may be levied upon such shares of stock, and pointing out the manner in which the officer shall proceed in making the levy.[1] Thus, by statute in Tennessee,[2] stock in all corporations is declared to be personal property and *subject to execution.*[3] In that State all corporate stocks which are made subject to execution by statute are subject to attachment in equity under the provisions of the code of that State, providing for an attachment in suits in chancery.[4] In Illinois corporate stock is not *subject to attachment.*[5] Under the Civil Code of California,[6] stock purchased by a corporation at a sale for delinquent assessments is held "subject to the control of the stockholders," and cannot be levied on under an execution against the corporation.[7]

§ 2766. When Shares in Foreign Corporation Leviable. — It has been held that the *situs* of corporate stock follows the *situs* of the corporation. Therefore, where a corporation is organized under the laws of one State of the Union, but has its office in another State, shares of its capital stock are not within the local jurisdiction of the latter State for the purpose of the levy of an execution thereon.[8]

§ 2767. Attachment of Shares not an Incumbrance of the Property of the Corporation. — It has already been pointed out [9] that the shareholder is not a part owner of the property of the corporation, but that the capital stock of the corporation is one species of property and the shares of the members are a different species of property.[10] Thus, although the property of the corporation may consist of *land*, yet the shares of the corporation are the *personal property* of the respective shareholders.[11]

[1] *Ib.* See Rev. St. Mo., 1855, p. 742, secs. 23, 24.

[2] Code Tenn., §§ 1487 and 3097; Code 1884, §§ 1715 and 3810.

[3] See Memphis Appeal Pub. Co. *v.* Pike, 9 Heisk. (Tenn.) 697.

[4] Cornick *v.* Richards, 3 Lea (Tenn.), 15; Young *v.* South Tredegar Iron Co., 85 Tenn. 189; *s. c.* 4 Am. St. Rep. 752.

[5] Rhea *v.* Powell, 24 Ill. App. 77.

[6] Cal. Civ. Code, § 344.

[7] Robinson *v.* Spaulding Gold & Silver Mining Co., 72 Cal. 32.

[8] Plimpton *v.* Bigelow, 93 N. Y. 592.

[9] *Ante*, § 1071.

[10] Morgan *v.* Railway Co., 1 Woods (U. S.), 15; Arnold *v.* Ruggles, 1 R. I. 165; Bradley *v.* Holdsworth, 3 Mees. & W. 422.

[11] Bradley *v.* Holdsworth, *supra*; *ante*, § 1066.

From this it follows that the attachment of the shares of a particular shareholder does not in the least incumber the property of the company or restrain it from assigning or conveying it.[1]

§ 2768. **Rights of the Purchaser at the Execution Sale.**— According to one view, one who purchases such shares under execution acquires no higher right, by virtue of his purchase, than the execution debtor himself had. If, therefore, the execution debtor, at the time when the shares are thus purchased, stands *indebted to the corporation*, and if the by-laws of the corporation prohibit the transfer of shares by shareholders who are indebted to the corporation, it is clear that the purchaser cannot claim the rights of a shareholder as against the corporation, without paying to the corporation the indebtedness of the previous shareholder; and, until this is done, he cannot maintain an action against the corporation as for a *conversion* of the shares which he has thus purchased.[2] Where this theory prevails, an *unregistered transfer* is effectual as against an execution creditor of the transferor, in the absence of a statutory prohibition, although there is a by-law forbidding transfers except upon the books of the company.[3] Under this theory, an attachment-execution in Pennsylvania would become a lien on the debtor's stock from the date of its service on the company; and upon judgment thereon, and a sheriff's sale, the purchaser of the stock would take the same title the judgment debtor had when the attachment was served.[4] But by the more widely prevailing theory,[5] an unrecorded transfer is ineffectual to pass the property as against an attaching creditor without notice. And where such attaching creditor is a corporation, it is not chargeable with knowledge of such transfer on the part of one of its directors, who had no knowledge of the attachment.[6] It is scarcely necessary to add that the purchaser acquires all the rights of the exe-

[1] Gottfried *v.* Miller, 104 U. S. 521, 528.

[2] Mechanics' Bank *v.* Merchants Bank, 45 Mo. 513; *s. c.* 100 Am. Dec. 388. See *post*, § 2780.

[3] Wilson *v.* St. Louis &c. R. Co., 108 Mo. 588; *s. c.* 32 Am. St. Rep. 624; 18 S. W. Rep. 286. See *ante*, § 2412, *et seq.*

[4] Geyer *v.* Western Ins. Co., 3 Pitts. (Pa.) 41.

[5] *Ante*, § 2409.

[6] Buttrick *v.* Nashua &c. R. Co., 62 N. H. 413; *s. c.* 13 Am. St. Rep. 578.

cution debtor, although he may have paid for the shares much less than their nominal or their real value; since shares of stock, like other property, are liable to bring less than their value at forced sales. In such a case the rights of other shareholders are not infringed, the case being entirely different from that where a corporation originally issues its shares at less than their par value.[1]

§ 2769. Attachment by the Corporation Itself.— If the shareholder is indebted to the corporation, that body is in as good a position in respect of a right to subject his shares to an attachment as any other creditor; and where the shares of the debtor member have been pledged as collateral security, but have not been conveyed on the books of the company to the pledgee or to his vendee, the corporation may attach the stockholder's interest, compel a sale, and have the surplus, remaining after the payment of the debt for which the shares stand pledged, applied to the payment of the debt due the corporation; and the attachment will take precedence over a later attachment by another creditor, by garnishment of the pledgee.[2]

§ 2770. Circumstances Charging the Corporation with Notice.— B., who was president and one of the directors of a corporation, on the 24th day of May, 1867, sold and transferred to the plaintiff a certificate for forty-five shares of the capital stock of the company, for which the plaintiff paid him $95 per share, the par value being $100 per share. The certificate provided that the shares were "transferable in person, or by attorney, only on the books of the company, on the surrender of this certificate." B. continued to act as president and director until January 27, 1868. On the following day the shares, not having been transferred on the books of the company, were *attached on a writ in favor of the company* against B., as the property of B. It was held that the company were chargeable, under the circumstances, with notice of the sale and transfer of the shares by B. to the plaintiff, and that, in the absence of fraud in fact on the part of the plaintiff, he was entitled to hold the shares against the attachment. It appeared that the agent who succeeded B., and who procured the attachment and caused the levy to be made on the shares, was a *director* in 1867,

[1] See the forcible observations of Mr. Justice McLean on this subject. Sturges *v.* Stetson, 1 Biss. (U. S.) 246; 10 Myer Fed. Dec., § 145.

[2] Norton *v.* Norton, 43 Ohio St. 509.

and knew of the sale and transfer of them to the plaintiff by B., prior to and at the time of the attachment; also that the treasurer of the company had actual notice of such sale and transfer prior to the attachment. Of course, the knowledge of these officers affected the company with notice.[1] - - - - But it has been held that a corporation, attaching shares which have been transferred without a record, is not chargeable with knowledge of the transfer possessed by one of its directors who takes no part in causing the attachment, and is not informed of it. The *knowledge of a single director*, in such a case, has been held not imputable to the corporation; since he is only one of the body of directors who can only act together as a board.[2]

§ 2771. Whether Equitable Title of Unregistered Transferee Subject to Attachment. — The solution of this question, in the absence of statutes expressly or impliedly controlling it, must depend upon the general rule which obtains in the particular jurisdiction as to whether equitable interests are subject to attachment. The inquiry starts upon the premise that at common law an equitable right or interest in personal property is not attachable.[3] "Hence," says Mr. Freeman, speaking of executions, "wherever the common law rule has not been changed by statute, the sheriff is not authorized to seize and sell any chattels, unless the defendant in execution has the legal as well as the equitable title thereto."[4] Proceeding upon this premise, it has been held in Rhode Island that the equitable title of the transferee in an unrecorded transfer of shares, cannot be

[1] Scripture *v.* Francestown Soap Stone Co., 50 N. H. 571.

[2] Buttrick *v.* Railroad Co., 62 N. H. 413; *s. c.* 13 Am. St. Rep. 578. As to *notice to corporations*, see *post*, Ch. 111.

[3] Freeman Ex., 2d ed., § 116.

[4] Citing Boyce *v.* Smith, 16 Mo. 317; McLeary *v.* Snider, 1 West L. M. 270; Lyster *v.* Dolland, 1 Ves. Jr. 431; 3 Bro. C. C. 478; Wilson *v.* Carver, 4 Hayw. (Tenn.) 90; Badlam *v.* Tucker, 1 Pick. (Mass.) 389; *s. c.* 11 Am. Dec. 202; Dargan *v.* Richardson, Dudley (S. C.), 62; Martin *v.* Jewell, 37 Md. 530; Rose *v.* Bevan, 10 Md. 466; *s. c.* 69 Am. Dec. 170; Wylie *v.* White, 10 Rich. Eq. (S. C.) 294; Shute *v.* Harder, 1 Yerg. (Tenn.) 3; *s. c.* 24 Am. Dec. 427; Roads *v.* Symmes, 1 Oh. 281; *s. c.* 13 Am. Dec. 621; Yeldell *v.* Stemmons, 15 Mo. 443; Hendricks *v.* Robinson, 2 Johns. Ch. (N. Y.) 312. See also Scott *v.* Scholey, 8 East, 467. Mr. Freeman very sensibly observes: "If such interests are to be subjected to forced sale, it is better to allow them to be taken under *fieri facias* than to compel the creditor to resort to a separate suit; for the suit, after subjecting both parties to delay and expense, without any compensatory advantages, does precisely what might long before have been done under a *fieri facias*." Freeman Ex., 2d ed., § 116.

seized under an *attachment*.[1] On the contrary, it has been held in Missouri, that the *equity of redemption* of one who has given a deed of trust in the nature of a mortgage, conveying his shares in a corporation, may be levied on and sold under *execution*, and that the purchaser will succeed to the rights of the mortgagor.[2] The Rhode Island court, in the case previously cited, reason that "if such rights were subject to levy and sale, a sale of them without identification or any disclosure in regard to them, — as the sale, if authorized, might be made, would generally be nothing but a most unconscionable sacrifice;"[3] a conclusion which seems sound except where it is applied in the case of fraudulent conveyances.

§ 2772. Shares of Stock Fraudulently Transferred Liable to Attachment although Transfer Registered — If, under the remedial system prevailing in a particular jurisdiction, shares of corporate stock are under any circumstances liable to attachment, then it logically follows, under the foregoing principles that they are so liable where they have been conveyed in fraud of creditors, notwithstanding the fact that they have been formally transferred to the fraudulent assignee on the corporate books. In such a case, it would be an unreasoning technicality which would allow the circumstance that they did not continue to stand in the name of the real owner on the corporate books to stand in the way of the rights of the creditor. The rule here stated is one of perfect simplicity, because in this regard it places shares of corporate stock upon the same footing as any other property, real or personal, and gives the creditor the same remedy in respect of it.[4]

§ 2773. Or to Seizure and Sale under Execution. — By parity of reasoning, shares of stock thus fraudulently transferred may be levied upon by execution and sold, although the

[1] Lippitt *v.* American Wood Paper Co., 15 R. I. 141; 2 Am. St. Rep. 886.

[2] Foster *v.* Potter, 37 Mo. 526. See also Middletown Savings Bank *v.* Jarvis, 33 Conn. 372.

[3] Lippitt *v.* American Wood Paper Co., *supra.*

[4] So held in Beckwith *v.* Burrough, 14 R. I. 366; *s. c.* 51 Am. Rep. 392; qualifying Falk *v.* Flint, 12 R. I. 14, and distinguishing Van Norman *v.* Jackson Circuit Judge, 45 Mich. 204.

transfer to the fraudulent assignee may have been formally made on the books of the corporation.[1]

§ 2774. Same Result under View that Statute is Declaratory of Common Law. — Other decisions reach the same result, but by a somewhat different process of reasoning,— holding that the statute is merely declaratory of the common law, and that any transfer of property which is liable to execution, if made by the owner with intent to hinder, delay or defraud his creditors, is void as to such creditors under the principles of the common law. And this is in conformity with the dictum of Lord Mansfield[2] that "the principles and rules of the common law, as now universally known and understood, are so strong against fraud in every shape, that the common law would have attained every end proposed by the statute."[3] If the premise is admitted that the statute is merely declaratory of the common law, the conclusion will unavoidably follow that the rule avoids fraudulent transfers of shares of corporate stock as well as fraudulent transfers of any other species of property; for, speaking of this particular subject, it has been justly said of the principles of the common law, "that these principles, however it may be with the statute, are not limited in their operation by any Procrustean formula, but that whenever any kind of property, tangible or intangible, becomes liable to be taken by attachment or execution for debt, they immediately extend to it their protection."[4]

§ 2775. Whether Purchaser Entitled to Maintain Bill in Equity Before Acquiring Possession.— The decision of this question will also be governed by the rule which prevails in the

[1] Scott *v.* Indianapolis Wagon Works, 48 Ind. 75, 79. See also State *v.* Warren Foundry and Machine Co., 32 N. J. L. 439.

[2] In Cadogan *v.* Kennet, 2 Cowp. 432, 434.

[3] The following authorities support the view stated in the text: Beckwith *v.* Burrough, 14 R. I. 366; *s. c.* 51 Am. Rep. 392; Sturtevant *v.* Ballard, 9 Johns. (N. Y.) 337; *s. c.* 6 Am. Dec. 281; Hamilton *v.* Russell, 1 Cranch (U. S.), 309; Clements *v.* Moore, 6 Wall. (U. S.) 299, 312; Blackman *v.* Wheaton, 13 Minn. 326; Hudnal *v.* Wilder, 4 McCord (S. C.), 294; *s. c.* 17 Am. Dec. 744; Peck *v.* Land, 2 Ga. 1, 10; *s. c.* 46 Am. Dec. 368; Fox *v.* Hills, 1 Conn. 295; Lillard *v.* McGee, 4 Bibb (Ky.), 165; 1 Story Eq. Jur., § 352.

[4] Beckwith *v.* Burrough, 14 R. I. 366; *s. c.* 51 Am. Rep. 392, opinion by Durfee, C. J.

particular jurisdiction, where the subject of the execution sale is land or tangible personal property. And here there is some contrariety of opinion among the courts. Some of the courts hold that equity will not interpose to aid the purchaser at the execution sale in such a case, at least not until he has obtained possession at law.[1] These courts proceed upon the view that the creditor should bring his proceeding in equity in aid of his execution after levy and before sale, so that a fair sale can be had without a sacrifice of the property. Other courts take the opposite view, and, while admitting that the property would probably sell better if the purchaser were not buying the speculative contingency of a lawsuit, nevertheless reason that if the transfer is fraudulent, the defendants, the fraudulent transferor and the fraudulent transferee, — are to blame for the circumstance, and if they suffer in consequence of it they have no right to complain.[2] Proceeding upon this view, it has been held that where corporate shares, transferred in fraud of creditors, have been attached and subsequently sold under execution, the purchaser of them at the execution sale may maintain a suit in equity to avoid the fraudulent transfer.[3] It is assumed by the writer that in such a case the form of relief would be to require the corporation or its secretary to transfer the shares on the books of the corporation to the complainant.[4]

§ 2776. View that Attachment Seizes only the Legal Title as Shown by the Corporate Books.— It is further to be kept in mind that an attachment is not a device for subjecting *equitable interests*. It seizes only the legal interest as shown by the books of the corporation. It cannot be levied on shares of corporate stock if the debtor is not himself the legal possessor of the interest, or where he has only an equitable right, or has regu-

[1] Cranson *v.* Smith, 47 Mich. 189; Thigpen *v.* Pitt, 1 Jones Eq. (N. C.) 49; Smith *v.* Cockrell, 66 Ala. 64; Messmore *v.* Huggard, 46 Mich. 558.

[2] Hildreth *v.* Sands, 2 Johns. Ch. (N. Y.) 35; Sands *v.* Hildreth, 14 Johns. (N. Y.) 493; Gallman *v.* Perrie, 47 Miss. 131; Pulliam *v.* Taylor, 50 Miss. 551; Frakes *v.* Brown, 2 Blackf. (Ind.) 295; Harrison *v.* Kramer, 3 Ia. 543; Gerrish *v.* Mace, 9 Gray (Mass.), 235; Murphy *v.* Orr, 32 Ill. 489; Tappan *v.* Evans, 11 N. H. 311; Lionberger *v.* Baker, 14 Mo. App. 353; *s. c.* affirmed, 88 Mo. 447, 455; Bobb *v.* Woodward, 50 Mo. 95; Ryland *v.* Callison, 54 Mo. 513; Zoll *v.* Soper, 75 Mo. 460.

[3] Beckwith *v.* Burrough, 14 R. I. 366; *s. c.* 51 Am. Rep. 392.

[4] *Post*, § 2794.

larly assigned his interest.[1] Accordingly it has been held that an attachment cannot be levied upon shares of stock which the debtor has previously assigned on the books of the corporation to his wife; and as a bill will not lie to protect the lien of such an attachment by enjoining the payment of dividends to the holder, such an injunction, if granted, can be vacated by mandamus.[2] In some jurisdictions, *e. g.*, in Missouri, — where the debtor has conveyed land in fraud of his creditors, a creditor may levy upon and sell his interest therein under his execution, and the execution purchaser may then maintain a suit in equity to set aside the fraudulent conveyance.[3]

§ 2777. View that Equity of Redemption in Shares is Attachable. — No legal obstacle seems to exist in the way of levying an attachment upon the equity of redemption of a mortgagor of corporate shares and selling them subject to the mortgage, even where the mortgage has been given to indemnify against uncertain liabilities other than the payment of money.[4] In the case of a levy upon the equity of redemption which the execution debtor has in ordinary personal property, the purchaser is entitled to pay off the mortgage, and thus make himself the absolute owner of the property.[5] The surplus, arising from the sale of such equity of redemption under the execution, is to be held by the officer and paid over to the next creditor in order of priority.[6] Accordingly, where a *statute* gives an *execution* against shares of stock in incorporated companies and provides for the manner in which the same may be levied, it is held to extend to an equity of redemption of a mortgagor or pledgor of such shares. By such a levy and a sale thereunder, the purchaser at the sale is put into the place of the execution debtor. The prior rights of the mortgagee are not necessarily interfered with. He may

[1] Van Norman *v.* Jackson Circuit Judge, 45 Mich. 204.

[2] *Ibid.*

[3] *Query*, whether there is any practical or theoretical obstacle in the way of such a remedy being available to the creditor in the case of a fraudulent conveyance by a debtor of shares of corporate stock?

[4] Norton *v.* Norton, 43 Oh. St. 509; Foster *v.* Potter, 37 Mo. 526. See 2 Hilliard Mortg., ch. 48. Compare Simmons *v.* Hill, 96 Mo. 679.

[5] Forbes *v.* Parker, 16 Pick. (Mass.) 462.

[6] Denny *v.* Hamilton, 16 Mass. 402.

still proceed to sell under his mortgage, or he may claim the property before the sheriff, or he may assert his rights in any other way known to the law. His conveyance, upon a sale under his power, may be effectual to pass the whole property in the stock. Notwithstanding the sale under execution, the purchaser takes the property subject to the incumbrance.[1] Under a statute of Texas,[2] providing that where the *garnishee* is an incorporated company, and the defendant is the owner of shares, the court shall order the sale of such shares, corporate stock held as *collateral security* is subject to *garnishment*.[3]

§ 2778. Levy upon Stock Held in the Name of a Nominal Owner.— The principle that the execution creditor gets only the title which his debtor has, has been applied to the case where the stock which was the subject of the levy stood in the name of the debtor, but had been placed in his name by a mistake; whereas it really belonged to his wife, so that, in equity, he held it as her *trustee*, though upon a *secret trust* so far as the creditor was concerned. It was held that, in the absence of evidence that the creditor had been misled or deceived to his disadvantage by the stock being so held, his levy gave him no right to subject the same, and that a sale of the same thereunder would be enjoined.[4] A similar view has been taken under an English statute which provides in substance that the shares of a debtor, against whom a judgment has been recovered, "standing in his name, in his own right or in the name of another person in trust for him," may be *charged* with the payment of the judgment debt, by procuring what is known in the English practice as a "charging order." It has been lately held in the English Court of Appeal, that where certain shareholders have transferred certain shares to a person not a shareholder, to *qualify* him to act as "managing director," and in order to enable them to hold him out to the public as *managing director*, upon an agreement that he is to be merely the nominal owner of the shares, he executing to them in return blank transfers of their respective holdings,— he is not a holder of shares "standing in his name, in his own

[1] Foster *v.* Potter, 37 Mo. 525, 531.

[2] Tex. Rev. Stat., art. 208.

[3] Smith *v.* Traders' Nat. Bank, 74 Texas, 457; *s. c.* 12 S. W. Rep. 113.

[4] Mowry *v.* Hawkins, 57 Conn. 453.

right," within the meaning of the statute; so that the shares thus held by him can not be charged with a judgment rendered against him.[1] In an earlier English case, where a transfer of shares was made from a father to his son to qualify the son as director of the company, it was held that a charging order could not be made upon the shares in respect of the son's debts, because he did not own them in his own right, but owned them as trustee for his father, although they stood in his own name.[2]

§ 2779. Pennsylvania Statute Requiring Affidavit and Recognizance.— A statute of Pennsylvania[3] requires the plaintiff issuing an attachment-execution against stock held in a name other than that of defendant, to file an affidavit and enter into a recognizance. This statute was intended to apply only to those cases where there is a claimant disputing the defendant's title, and not to those cases where the defendant's title is conceded.[4]

§ 2780. Rights of Corporation as Against Attaching Creditor.— Where, under principles already discussed,[5] a company has a lien to more than its value upon the stock standing on its books, in the name of a judgment debtor, and such stock is sold under an execution against the debtor, there is nothing to be transferred to the purchaser, except upon the payment by the latter of the amount secured by the lien.[6]

§ 2781. Continued: Decisions on Particular States of Fact.— A subscriber for ninety bank shares, of $100 each, paid $2,750 towards an installment of eighty per cent., and drew a draft in favor of the bank for the balance, and transferred to the bank all his rights, etc., in his shares (excepting and reserving the sum he had paid in money), as collateral security for payment of the draft. The draft

[1] Cooper *v.* Griffin (1892), 1 Q. B. 740. The court commented upon Pulbrook *v.* Richmond Consolidated Mining Co., 9 Ch. Div. 610, and distinguished Cragg *v.* Taylor, L. R. 1 Exch. 148, on the ground that it had been decided prior to the passage of the judicature acts which blended law and equity, and that it proceeded upon the ground that whatever might be the equitable rights of the judgment debtor, those rights could not be enforced in a court of law.

[2] Re Blakely Ordnance Co., 25 Week. Rep. 111; *s. c.* 35 L. T. (N. S.) 617.

[3] Pa. Act, June 16, 1836, § 32.

[4] Betts *v.* Towanda Gas &c. Co., 97 Pa. St. 367; Eby *v.* Guest, 94 Pa. St. 160.

[5] *Ante*, § 2317, *et seq.*

[6] Newberry *v.* Detroit &c. Co., 17 Mich. 141.

was not paid, nor did the bank pass to the subscriber's credit any stock, nor give any certificates for shares. It was held that the subscriber was once an owner of the shares, and that the effect of the reservation in his conveyance to the bank was, that an amount equal to thirty-four shares, of the par value of $80 a share, remained his property, and was liable to be sold on an execution against him.[1] - - - - In another case a note drawn by C. to the order of A. and B., and jointly indorsed by them, was discounted at a bank where A. held stock, was protested for non-payment, and judgment confessed by A. and C. to the bank for the amount. Afterwards D. obtained a judgment against A. upon which he issued execution, and levied upon and bought the stock at the sale. The bank then obtained judgment against A. and B. on their joint indorsement, and issued executions on both of their judgments, upon which A.'s stock was again levied on; when B., one of the indorsers, paid the debt to the bank, took an assignment of the judgments to his use, and on the execution against A. and C. purchased A.'s stock. The bank refusing to transfer the stock to B., he brought suit; when D. interpleaded, claiming it under the sheriff's sale to him. It was held that the payment of the debt by B., with the assignments of the judgments, did not extinguish the lien of the bank on the stock which attached upon the protest of the note; that, by virtue of the assignments, B. acquired all the rights of the bank and became entitled to all its remedies; and that, under the second sale, he took a good title to the stock notwithstanding the previous sale to D.[2]

§ 2782. Rights of Subsequent Bona Fide Purchaser where Corporation Issues a New Certificate to the Purchaser at a Void Judicial Sale of the Shares. — Let us recur to the case considered in the previous section, where there has been a void judicial sale of the corporate shares, and the corporation, without taking the pains to advise itself of the legality of the sale, cancels the old certificates, and on the demand of the purchaser issues new ones to him, and he subsequently sells them to a *bona fide* purchaser without notice of any informality attaching to them. What are his rights? In order to determine this question it is necessary to recur to the doctrine of a preceding chapter.[3] A certificate of stock is a continuing affirmation by the corporation which has issued it that the person named therein, or his lawful

[1] Hussey *v.* Bank, 10 Pick. (Mass.) 415.

[2] West Branch Bank *v.* Armstrong, 40 Pa. St. 278.

[3] *Ante*, §§ 2350, 2544.

assignee, is entitled to the rights of a shareholder in the corporation in respect of the number of shares therein stated. But suppose (and that is the case we are considering) that the corporation issues such a certificate *falsely*, when some other person is really the owner of the shares therein named, and entitled to the rights of a shareholder in respect of the same. Clearly the holder of the new certificate cannot claim the rights of a shareholder as against the real owner, and it may be doubtful whether he can claim them as against the corporation; for to admit such a principle would be in some cases to concede that a corporation might be compelled, as the result of its inadvertent and illegal act, to issue certificates of its shares in excess of the amount allowed by law. But clearly the holder of the new certificates has an action against the corporation for the damages which he has suffered through its failure to make good to him the representation which the certificate contains. Of this there is no question.[1] Nor is the *bona fide* purchaser of the shares under such circumstances liable to account to the real owner. To this extent shares partake of the qualities of negotiable paper.[2]

ARTICLE II. PROCEDURE.

§ 2786. Situs of Corporate Stock for the Purpose of Seizure by Attachment or Execution. — So far as the writer knows,

[1] *Ante*, § 2595.

[2] Citizens' Street R. Co. *v.* Robbins, 128 Ind. 449; *s. c.* 25 Am. St. Rep. 445; 12 L. R. A. 498; 9 Rail. & Corp.

all the States which prescribe the manner of levying upon shares of corporate stock by execution or attachment, prescribe that it shall be done by giving *notice* to the corporation, or to its secretary, or to the officer having charge of its books,—[1]this notice to the officer in charge of the corporate books being essential to the validity of the seizure. The effect of such a statutory provision necessarily is to make the *situs* of corporate shares for the purpose of the levy of an execution or attachment the *situs* of the corporation itself.[2] It follows that shares owned by a non-resident defendant in the stock of a foreign corporation cannot be reached and levied upon by virtue of an attachment, although officers of the corporation are in the State of the forum, engaged in carrying on the corporate business there.[3] But when the foreign company has, by appropriate legislation, been vested with the character and status of a domestic corporation,[4] then its stock has been held to be within the jurisdiction of the local court and subject to execution.[5]

§ 2787. Effect of Statutes Making Foreign Corporations Domestic Corporations.—In Tennessee there is a statute, such as now exists in many of the States, providing for the registration of the charters of foreign corporations doing business within the State, and also providing that "such corporations shall be deemed and taken to be corporations of this State, and shall be subject to the jurisdiction of the courts of this State, and may sue and be sued therein in the mode or manner that is or may be by law directed in the case of corporations created or organized under the laws of this State." Under this statute it is held that the *situs* of a foreign corporation, and the *situs* of its shares

L. J. 155; citing Salisbury Mills *v.* Townsend, 109 Mass. 115; Bank *v.* Field, 126 Mass. 346; Turnpike Co. *v.* Ferree, 17 N. J. Eq. 117; Pratt *v.* Manufacturing Co., 123 Mass. 110; *s. c.* 25 Am. Rep. 37; Allen *v.* South Boston R. Co., 150 Mass. 200; *s. c.* 15 Am. St. Rep. 185.

[1] Code Tenn., § 3035; Code (M. & V.) 1884, § 3748.

[2] Young *v.* South Tredegar Iron Co., 85 Tenn. 189; *s. c.* 4 Am. St. Rep. 752.

[3] Plimpton *v.* Bigelow, 93 N. Y. 592; *s. c.* 66 How. Pr. (N. Y.) 131; 13 Abb. N. Cas. (N. Y.) 173; reversing *s. c.* 29 Hun (N. Y.), 362; 12 Abb. N. Cas. (N. Y.) 202, and affirming *s. c.* 11 Abb. N. Cas. (N. Y.) 180; 63 How. Pr. (N. Y.) 484. The provision of N. Y. Code, sec. 647, only applies to domestic corporations. *Ibid.* See also Moore *v.* Gennett, 2 Tenn. Ch. 375.

[4] Tenn. Code (Mill. & V. 1884), §§ 1992–2003. See Railroad Co. *v.* Harris, 12 Wall. (U. S.) 82; Ohio &c. R. Co. *v.* Wheeler, 1 Black (U. S.), 297.

[5] Young *v.* South Tredegar Iron Co., 85 Tenn. 189; *s. c.* 4 Am. St. Rep. 752.

and stock for the purposes of such a levy, are transferred to *its principal office within the domestic jurisdiction.* Accordingly, where the corporation was created under the laws of Missouri for the purpose of carrying on business in Tennessee, and one of its shareholders resided in Illinois, it was held that the levy of an attachment upon the shares of such shareholder might be effected in Tennessee, in the mode pointed out by the statute.[1]

§ 2788. Statutes Authorizing Execution Against Corporate Stock Must be Substantially Complied With. — As corporate stock was not subject to levy at common law, it is a reasonable deduction, and one often made by the courts, that statutes subjecting this species of property to execution and pointing out the mode of procedure must be substantially complied with, or the sale will be held void.[2]

§ 2789. Duties and Responsibilities of Levying Officer, under the successive *statutes of Massachusetts* making the body and estate of the stockholder liable to be taken in execution under a judgment against the corporation, have been pointed out in several cases. He must necessarily be governed by directions not contained in the precept directed to him. He could not know by his precept who were the individual stockholders liable thereto, and on whom the creditor elected to levy it. He must receive his information and take his directions in this respect from the creditor; and the statute made it his duty to follow such directions,[3] although he might require indemnity.[4] Though a creditor who had two or more demands against a manufacturing company, one only of which the stockholders were liable to pay, recovered a single judgment on all the demands, yet he might levy his execution on the personal property of a stockholder to the amount of the demand which the stockholders were liable to pay.[5]

§ 2790. Manner of Making Levy.— As shares of stock can, as a general rule, only be transferred on the books of the corpo-

[1] Young *v.* South Tredegar Iron Co., 85 Tenn. 189; *s. c.* 4 Am. St. Rep. 752. Compare Plimpton *v.* Bigelow, 93 N. Y. 592, cited in the preceding section.

[2] Howe *v.* Starkweather, 17 Mass. 240; Princeton Bank *v.* Crozer, 22 N. J. L. 383; *s. c.* 53 Am. Dec. 254; Blair *v.* Compton, 33 Mich. 414, 423.

[3] Leland *v.* Marsh, 16 Mass. 389; Marcy *v.* Clark, 17 Mass. 330.

[4] Stedman *v.* Eveleth, 6 Metc. (Mass.) 125.

[5] Stedman *v.* Eveleth, 6 Metc. (Mass.) 125. See also Richmond *v.* Willis, 13 Gray (Mass.), 182.

ration, it would seem to follow that, in order to effect a transfer through the agency of judicial process, the officers of the corporation would have to be *notified.* It is supposed that the manner of levying upon corporate shares is regulated, or at least suggested, by statute in every State. These statutes generally require that a notice of the levy be given by the levying officer to the president or other managing officer or agent of the corporation. Under some of them, a levy is generally effected by leaving an attested copy of the writ with the proper officer of the corporation.[1] For instance, a statute of Illinois provides that "the officer shall leave an attested copy of the execution with the clerk, treasurer, or cashier of the company," or, where there is no such officer, "with any officer or person having the custody of the books and papers of the corporation; and the property shall be considered as seized on execution when the copy is so left and shall be sold in like manner as goods and chattels."[2] Another section provides that "the officer of the company who keeps a record or account of the shares or interest of the stockholders therein, shall, upon the exhibiting to him of the execution, be bound to give a *certificate* of the number of shares," held by the judgment debtor.[3] The *secretary* of the corporation is its "clerk, treasurer or cashier," within the meaning of the above statute. On this point the Supreme Court of Illinois said: "Where a *clerk* is mentioned as an officer of such a corporation, and not as a mere employé, we understand that term to mean that officer who usually has the custody of the books and records of the company. The secretary of such a corporation is but another name for the same officer."[4] So much of the above statute as requires "an attested copy" of the execution to be left with the clerk of the corporation, is satisfied when a copy of the execution is thus left, *attested by the sheriff.* It need not be attested by the clerk of the court.[5] The following indorsement of the sheriff has been held a good attestation

[1] Union Nat. Bank *v.* Byram, 131 Ill. 92; *s. c.* 23 N. E. Rep. 842; 7 Rail. & Corp. L. J. 148; Wyoming Fair Asso. *v.* Talbott, 3 Wyo. 244; 21 Pac. Rep. 700.

[2] Rev. Stat. Ill. 1874, Chap. 77, § 53.

[3] *Ibid.*, § 55.

[4] People *v.* Goss &c. Man. Co., 99 Ill. 355, 361.

[5] *Ibid.*

to satisfy the statute: "The within is a true copy of the execution and fee bill in my hands, under which I have seized the shares of stock of the within named defendant."[1] And although such an attestation is delivered by the sheriff to the officer of the corporation *without being signed* by the sheriff, yet the signature of the sheriff is something which the corporation can *waive*, and which it has been held it does waive, by delivering to the sheriff the certificate of the number of shares required by section 55 of the statute as above recited. The court take the view that a valid levy is accomplished when the sheriff gets possession, by virtue of his execution, of the certificate of the shares standing in the name of the execution debtor, given to him in pursuance of the statute, by the secretary of the corporation, for the purpose of the levy, and when the sheriff indorses upon his execution that he has so levied.[2]

§ 2791. Duty of Secretary of Corporation to Give Information.— To facilitate the discovery of stockholders, statutes exist in several of the States requiring the officer having charge of the books of the corporation to furnish the names of the shareholders on *demand* of the officer holding the execution. It has been held, under such a statute, that the demand must be made before the court will order the names to be furnished.[3] Many of these statutes provide that the officer appointed by the corporation to keep a record or account of the shares or interest of the stockholders shall, upon the execution being delivered to him by the levying officer, give to the latter a *certificate* of the number of shares or amount of the interest held by the judgment debtor.[4] It has been held in Michigan by two judges that a compliance with the provisions of such a statute is not absolutely necessary to the validity of a sale under execution of the shares of the judgment debtor, provided the sheriff ascertains from *any source* the actual number of shares owned by him and puts them up and makes a sale of them.[5]

1 *Ibid.*

2 *Ibid.*

3 Cleveland Rolling Mill Co. *v.* Texas & St. Louis Ry. Co., 23 Fed. Rep. 720.

4 Such is a statute of Michigan: Comp. Laws Mich. 1871, § 6114; and of Illinois: Rev. Stat. Ill. 1874, ch. 77, § 55.

5 Blair *v.* Compton, 33 Mich. 415, 435, per Marston, J., and Cooley, C. J.

§ **2792. Notice to Officer of Corporation.**— A statute of New York[1] provided that the levy might be made by leaving a copy of the warrant of attachment with either of the officers or agents of the association or corporation named, or with the debtor or individual holding such property, *with notice showing the property levied on*, etc. It has been held that it is not necessary, in order to the valid levy of an attachment, that this notice should specify particularly the property or debts supposed to be in the possession of or owing by the individual served with the notice. A *general notice* by the sheriff that he attaches all property, debts, etc., belonging or owing to the defendant in the attachment suit, in the possession or under the control of the individual served, has been held sufficient. The reason is that "the individual served necessarily knows better than the officer can know the property and debts in his possession or owing by him subject to attachment. A notice by the sheriff that he attached all the bonds, mortgages and promissory notes belonging to the attachment debtor, in the possession of an individual, would be good without specifying the particular securities and the names of the debtors; and if perchance there should be but one bond or mortgage, and no promissory note, the excessive claim would not vitiate. If a case could be supposed in which a party could be misled or injured, by the generality of a notice of this kind, it might be different. To require a particular description of the rights, debts and choses in action, which would identify and distinguish them from all others of a like kind, would be to render the remedy by attachment in a great majority of cases, abortive, as a process against property of this character."[2] Under one such statute,[3] the *notice* must be in *writing;* and an oral notice, with an indorsement of the levy on the stub of the stock book, is insufficient.[4] But, under section 1673 of the Code of Alabama, providing that shares of stock in a corporation may be attached by making a prescribed indorsement on the writ and giving notice to the custodian of the books of the corporation, an *oral notice* has been held sufficient.[5]

[1] New York Code Civ. Proc. (Wait, 1871), § 235.

[2] O'Brien *v.* Mechanics' Ins. Co., 56 N. Y. 52, 58, opinion by Allen, J.

[3] Iowa Code, §§ 2967, 3050.

[4] Moore *v.* Marshalltown &c. Co., 81 Iowa, 45; *s. c.* 46 N. W. Rep. 750.

[5] Abels *v.* Planters' &c. Ins. Co., 92 Ala. 382; *s. c.* 9 So. Rep. 423.

§ 2793. Sheriff's Return and Conveyance must Identify the Number of Shares.— But the principle first stated in the preceding section extends only to the manner of notifying the proper corporate officer that the sheriff attaches the shares of the execution debtor in the hands of a corporation. For obvious reasons, it does not extend so far as to justify a *return* of an attachment of such shares in general language, without describing their number or the number of the certificates, or furnishing any other means of identification, — such as "all the shares of stock owned and belonging to the said John Stone in said J. Stone & Sons Live Stock Company, and all the right, title and interest which the said John Stone had on the 12th day of January, A. D. 1886, or at any time afterwards, of, in, and to the said shares of stock;" and for the same reason a *conveyance* following a similar vague description will not operate to pass title to any shares of the execution debtor. The reason is that where no mention is made in such a return and conveyance of the number and description of the shares which are the subject of the levy, there is nothing to prevent an excessive levy, and a very large estate might be sold to satisfy a very small judgment, and that too when the property was capable of division. It would lead to a sacrifice of the interests of both the debtor and the creditor, resulting from the fact that what had been seized and was to be sold might be entirely unknown to the bidder.[1] On the other hand, it seems to be unnecessary for the sheriff to state in his return the *number* of the share certificates or of the shares, provided he *identifies* them by giving the number levied upon and the name of their owner. Thus, it was held that a sheriff's return describing the subject-matter of such a levy as twenty shares of the capital stock of the Stamford Bank, being the property of the debtor in the execution, and as having been attached in virtue of the original attachment in the suit, is sufficient. The court reasoned that "shares of stock are owned by different persons, and otherwise only are distinguishable from each other, as the stock of A. and the stock of B. A share is a definite proportion of the capital. Richards, the debtor in this case, owned twenty of these shares, thus showing his interest in

[1] Keating *v.* Stone &c. Co., 83 Tex. 467; *s. c.* 18 S. W. Rep. 797.

the capital of the bank, and this was attached as his, and could not be mistaken for the interest of any other person."[1] The view taken by two judges of the Supreme Court of Michigan in a case where the judgment below was affirmed by a divided court was to the effect that an execution sale, under a notice describing the property as all of the stock of a corporation named, standing in the defendant's name on the books of the company, or legally or equitably owned by him on specified days, the precise number of shares being unknown, but estimated to be 11,000 shares, where the amount owned by the debtor at the sale was represented to be at least 4162 shares, is good as against the objections of the debtor, if the purchaser makes no complaint, and is a valid sale to the extent of the 4162 shares, but void as to the excess.[2]

§ **2794. Remedy of Execution Purchaser to Compel a Transfer.** — Unless the governing statute prescribes a special remedy to the purchaser at the execution sale to compel a transfer of the shares by the corporation on its books, it is presumed that he has the same remedy which any conventional purchaser of shares in the same company would have,— which, as already seen,[3] is usually an action against the corporation for damages for the conversion of his shares.[4] On principles suggested by the preceding section, and gone into in a preceding chapter,[5] the corporation has the same right of lien, and consequently the same right to negative the transfer, that it would have in the case of an attempted sale by the shareholder; if it could in the case of a fraudulent transfer refuse a transfer on its books until the shares were paid up, it can do so in the case of an attempted transfer by a sale under execution. But it manifestly cannot resist such a right of transfer on the ground that the shareholder who was the judgment defendant was indebted to the corporation on general account, which indebtedness was no lien on the shares. It has even been held that a purchaser at a sheriff's sale of bank stock can compel a transfer of the shares on the books of the bank, although the judgment

[1] Stamford Bank *v.* Ferris, 17 Conn. 259, 268.

[2] Blair *v.* Compton, 33 Mich. 415.

[3] *Ante*, § 2425.

[4] As to the remedy of an execution purchaser under Louisiana procedure, see Weiser *v.* Smith, 22 La. An. 156.

[5] *Ante*, § 2317, *et seq.*

debtor may owe the bank at the time an amount above the amount of the stock purchased, evidenced by his notes held by the bank, notwithstanding a clause in the by-laws of the bank, adopted by the board of directors, subsequently to the issuing of the stock, that "no transfer of stock shall be made when the party is indebted to the bank as principal, indorser or security, on any obligation that is due, as long as it remains unpaid." The reason assigned is that such a by-law is not binding on the judgment creditors of the stockholders.[1] In some States, no doubt by force of statute, the purchaser at execution sale has a remedy by *mandamus* to compel the corporation to transfer the shares to him on its books.[2]

§ 2795. Duty and Responsibility of the Corporation in Respect of Such Sales. — The duties and responsibilities of the corporation in respect of an *administrator's sale* of the stock of a deceased member has been lately the subject of consideration by the Supreme Court of Indiana. The observations of the court are equally applicable to an execution or to any other so-called judicial sale. Before the corporation makes a transfer of the shares on its books to the purchaser, it is his duty to inform himself that the administrator had power to sell, and that the sale took place in substantial compliance with the applicatory statutes. If, in the case of an administrator's sale, without ascertaining these facts, the corporation, on the demand of the purchaser, cancels the old certificates and issues new ones to the purchaser, it will be liable to the estate for a conversion of the shares.[3]

§ 2796. Equitable Action to Subject Railway Shares Held by the County. — The judgment creditor of a county may maintain a suit in equity to subject to his execution shares of stock in a railway company held by the county; but in order to do so he must make it appear that the shares are not necessary for any *governmental purpose* of the county, that they are not incum-

[1] Bryon *v.* Carter, 22 La. An. 98.

[2] People *v.* Goss &c. Man. Co., 99 Ill. 355.

[3] Citizens' Street R. Co. *v.* Robbins, 128 Ind. 449; *s. c.* 25 Am. St. Rep. 445; 12 L. R. A. 498; 9 Rail. & Corp. L. J. 155; citing Ang. & A. Corp. 10th ed., § 582; Nugent *v.* Laduke, 87 Ind. 486; Weyer *v.* Bank, 57 Ind. 198, 211; Loring *v.* Salisbury Mills, 125 Mass. 138.

bered in any way by legislative action, and that the dividends arising from them are not devoted by the governing statute to some corporate purpose. In other words, he must make it appear that they are held merely as *private property;* and to this end, if they are held under a *special statute*, he must plead that statute.[1] This decision refers itself to the well-known rule that property which is necessary to enable a municipal corporation to carry on its governmental functions is not subject to the levy of an execution.

§ 2797. Action for Permitting Transfers in Contravention of a Charging Order.— In an action under a statute[2] against a company for permitting the transfer of shares after notice of a *charging order nisi*[3] and before the making of it absolute, it is a good answer to show that the judgment debtor in whose name the shares stood had no beneficial interest in them, for in such a case the judgment creditor was not injured.[4]

§ 2798. When Transfer to Purchaser not Compelled.— Where the governing statute declares that the sheriff's deed shall vest title in the purchaser, it has been held that a transfer on the books of the corporation is not necessary and will not be compelled.[5]

[1] Hughes *v.* Craven County Commrs., 107 N. C. 598; *s. c.* 12 S. E. Rep. 465.

[2] 1 and 2 Vict., 110, § 15.

[3] A species of execution by a judgment creditor: Cragg *v.* Taylor, L. R. 1 Exch. 148; Fuller *v.* Earle, 7 Exch. 796; *s. c.* 21 L. J. Exch. 314; Watts *v.* Porter, 3 El. & Bl. 743; *s. c.* 23 L. J. Q. B. 345; Baker *v.* Tynte, 2 El. & E. 897; *s. c.* 29 L. J. Q. B. 233.

[4] Gill *v.* Continental Union Gas Co., L. R. 7 Exch. 332.

[5] Lippitt *v.* American Wood Paper Co., 14 R. I. 301.

CHAPTER XLII.

TAXATION OF SHARES AND DIVIDENDS.

ARTICLE I. GENERAL CONSIDERATIONS.

§ **2803. Scope of this Chapter.** — In concluding the subject of shares considered as property, it seems best to devote a chapter to a consideration of the subject of taxation of corporate shares as distinguished from the taxation of corporate capital, corporate franchises, or other corporate property. Decisions under particular statutory systems are not within the plan of this discussion; but some of them are here referred to in a marginal note for convenience of reference.[1]

[1] Shares of stock owned by individuals in manufacturing companies were not subject to taxation under the Missouri revenue law as it existed in 1879. Valle *v.* Ziegler, 84 Mo. 214. Under the revenue act of Illinois of 1872, the *capital stock* of corporations created under the laws of that State were taxable, and the *shares* of stock of such corporations were exempted from taxation; but when a resident of that State owned shares of stock in a cor-

§ 2804. Shares Taxable Under the Designation of "Property."— It has been held that shares of stock in a corporation are taxable under the general designation of "property," in a constitutional provision or in a revenue law, and without being specially named as subjects of taxation.[1]

poration created by the laws of another State, they were taxable against him. Porter *v.* Rockford &c. R. Co., 76 Ill. 561, 563. Statutes of Maryland exempting "*railroad companies*" from taxation in respect of shares of their capital stock have been held not to apply to *street railroad* companies, but only to *steam railroad* companies, which latter were taxed upon their gross earnings by another statute. Baltimore *v.* Baltimore &c. R. Co., 57 Md. 31. Stockholders in corporations not included in a statute of Kentucky, (Gen. St. Ky., ch. 92, art. 12), which required certain corporations to report and pay taxes on their property, and section 8 of which enacted that the individual stockholders of the companies therein referred to should not be required to list their shares in such companies for taxation, were individually liable for taxes on their shares of stock prior to act Ky. April 22, 1884, which made all corporations subject to that statute. Whitaker *v.* Brooks, 90 Ky. 68; *s. c.* 13 S. W. Rep. 355. In Texas and Kentucky, if a corporation fails to return for taxation any of *its property*, this does not authorize an assessor to list *its shares* for taxation. Gillespie *v.* Gaston, 67 Tex. 599; *s. c.* 4 S. W. Rep. 248; Whitaker *v.* Brooks, 90 Ky. 68; 11 Ky. Law Rep. 871; *s. c.* 13 S. W. Rep. 355. The Ohio act of April 16, 1870, entitled "An Act to enable Railroad Companies to Redeem their Bonded Debts" (67 Ohio Laws, 89) authorizes the issue of *preferred stock*, and not of certificates of indebtedness. The holders of certificates issued under it are *stockholders*, and not creditors, and under Ohio Rev. Stat., § 2746, are not required to list their shares for taxation in Ohio. Miller *v.* Ratterman, 47 Ohio St. 141; *s. c.* 23 Ohio L. J. 416; *ante*, § 2236. Section 3640 of the Political Code of California was declared unconstitutional, in so far as it related to the taxation of national bank shares, as imposing a tax upon such shares at a greater rate of taxation than that imposed upon other moneyed capital in the hands of citizens of the State, and therefore being in conflict with the National Banking Act. Miller *v.* Heilbron, 58 Cal. 133. The same section of the California Code did not prevent the taxation of stock owned in California in a corporation existing out of that State. San Francisco *v.* Fry, 63 Cal. 470; San Francisco *v.* Flood, 64 Cal. 504; *s. c.* 1 West Coast Rep. 567. Shares of stock in corporations were taxable under the constitution of California of 1849, and under the revenue laws in force in that State in 1877. San Francisco *v.* Flood, 64 Cal. Rep. 504.

[1] San Francisco *v.* Flood, 64 Cal. 504, 507. Compare Henkle *v.* Keota, 68 Iowa, 334, 338. There is certainly room for debate on the question whether *choses in action*, which in general are merely evidences of debt, are to be regarded as "property," within the meaning of a constitutional provision, or a revenue law, unless specially named as subjects of taxation. If we take, for instance, the case of a promissory note secured by a mortgage upon land, the taxation of the land on the one hand, and of the note and mortgage on the other, results, to a mathematical demonstra-

§ 2805. Taxability of Stockholders in Distillery Companies Under United States Internal Revenue Law.— The stockholders in a corporation engaged in operating a distillery

tion, in *double taxation*, the burden of which always falls in the end on the debtor or borrower. This question has been the subject of a succession of judicial decisions in California, under the following provision of the constitution of 1849 of that State: "Taxation shall be equal and uniform throughout the State. All property in this State shall be taxed in proportion to its value, to be ascertained as directed by law." Cal. Const. 1849, Art. XI., Sec. 13. In People *v.* McCreery, 34 Cal. 432, it was held, after a very elaborate consideration of the question, that a debt secured by a mortgage upon real property was taxable as the "property" of the creditor, and that a statute by which the legislature undertook to *exempt* such property from taxation would be unconstitutional. The general doctrine of this case, that the revenue laws of the State are unconstitutional in so far as they attempt to exempt private property from taxation, and that such statutes are to be read with the exemption clause omitted, was reaffirmed in People *v.* Gerke, 35 Cal. 677, in respect of a statute assuming to exempt *growing crops* from taxation. In People *v.* Black Diamond Coal Mining Co., 37 Cal. 54, the same doctrine was reaffirmed, and the court held that a clause in a revenue law assuming to exempt from taxation *possessory claims and improvements upon the public lands*, was unconstitutional and void. It should be observed that it had been previously held, in several cases in that State, that the possession of and claim to public land — in other words, what has been often called in our western frontier life "a squatter right"— was taxable to the claimant. People *v.* Shearer, 30 Cal. 645, 656; People *v.* Frisbie, 31 Cal. 146; People *v.* Cohen, 31 Cal. 210. The question of the power of the legislature to exempt *solvent credits* from taxation was re-agitated in People *v.* Eddy, 43 Cal. 331; *s. c.* 13 Am. Rep. 143, in which the court reaffirmed the doctrine of People *v.* McCreery, *supra*, and again held that a solvent debt, secured by promissory notes and mortgages upon real estate, is "property" within the constitutional provision above quoted, and that an act of the legislature exempting it from taxation in the hands of the creditor is hence unconstitutional and void. Rhodes, J., wrote the opinion of the court, and the doctrine was adhered to after a rehearing. But in people *v.* Hibernia, &c. Bank, 51 Cal. 243; *s. c.* 21 Am. Rep. 704, the question was again stirred, and the doctrine of People *v.* McCreery and People *v.* Eddy, *supra*, was overruled,— the court now taking the position that credits are not "property," in the sense in which the word "property" is used in the constitutional provision above quoted, and cannot be assessed for taxation or taxed as property, even if secured by a mortgage; and this notwithstanding a provision of the Political Code requiring that all property shall be taxed, and declaring that "personal property shall include money, goods, chattels, evidences of debt, and things in action." The scope of this decision seems to be that, the legislature having seen fit not to enact in terms that solvent credits shall be taxed as property, the constitutional provision above quoted does not require the assessing officers to list such credits for taxation. Mr. Justice Rhodes dis-

have been held to be "persons interested in the use of the distillery," within the meaning of a statute of the United States,[1] which declares that "every proprietor or possessor of, and every person in any manner interested in the use of, any still, distillery, or distilling apparatus, shall be jointly and severally liable for the taxes imposed by law on the distilled spirits produced therefrom."[2]

§ 2806. **When Joint-stock Companies Taxable as Corporations.**— In the State of New York, joint-stock companies, as is well known, are organized under certain enabling statutes which confer upon them the chief incidents of business corporations, although under the name of joint-stock companies or associations. They are hence regarded as corporations rather than as partnerships. For instance, where a joint-stock company, so organized, carries on the business of a common carrier, one of its members may maintain an action, in the nature of an action at law, against it, for the loss of goods intrusted to it for carriage.[3] Such a company was, in another case, regarded as hav-

sented. Such was the state of the law in California at the time of the rendition of the decision in San Francisco *v.* Flood, 64 Cal. 504, the doctrine of which is stated in the text, where it was held that, notwithstanding the decision in People *v.* Hibernia Bank, *supra,* shares of stock in corporations in that State are assessable as "property" under the constitutional mandate and under the designation of "property" in revenue laws, unless it is made to appear, under section 3640 of the Political Code, that the entire capital or property of the corporation in which the shares are owned is otherwise assessed. The last decision has been, in its turn, annulled by the people of California, in establishing their new constitution of 1877, in which they inserted these provisions: "All property in the State, not exempt under the laws of the United States, shall be taxed in proportion to its value, to be ascertained as provided by law. The word 'property,' as used in this article and section, is hereby declared to include moneys, credits, bonds, stocks, dues, franchises, and all other matters and things, real, personal, and mixed, capable of private ownership; provided, that *growing crops*, property used exclusively for public schools, and such as may belong to the United States, this State, or to any county or municipal corporation within this State, shall be exempt from taxation. The legislature may provide, except in the case of credits secured by mortgage or trust deed, for a reduction from credits or debts due to *bona fide* residents of this State."

[1] Rev. Stat. U. S., § 3251.

[2] United States *v.* Wolters, 46 Fed. Rep. 509.

[3] Westcott *v.* Fargo, 6 Lans. (N. Y.) 319; *s. c.* affirmed, 61 N. Y. 542: *s. c.* 19 Am. Rep. 300.

ing all the attributes and incidents of a corporation, except a common seal.[1] They are therefore taxable, under the statutes of that State, in a manner similar to that in which corporations are taxable.[2] In Massachusetts, where there does not appear to be any such enabling statute, but where unincorporated joint-stock companies must be formed, if at all, by instruments of writing in the nature of deeds or declarations of trust, which stand on the footing of a mere private compact among the members and their successors, and where there is no separate scheme of taxation applicable to unincorporated joint-stock companies, and no distinct statutory provision for the taxation of shares of such companies,— it is held that such shares are not taxable against their members, but that the taxing power exerted by the legislature of that State in respect of such companies is exercised in the taxation of their tangible property at its *situs;* and a confirmation of this view is discovered in the fact that under the statutory system of taxation existing in that State applicable to corporations, the value of the tangible property is deducted in assessing the value of the share capital; whereas, if the shares of unincorporated joint-stock companies were held to be taxable as separate items of personal property against their holders, this would result in a double taxation and would be inequitable.[3] But a *foreign* unincorporated joint-stock insurance company, doing business in Massachusetts under the permission of its statutes relating to foreign insurance companies, has been held to be, in substance and effect, a corporation, so as to come within the purview of a statute of that State relating to the taxation of foreign corporations.[4]

[1] Waterbury *v.* National Union Ex. Co., 50 Barb. (N. Y.) 158. See also Robbins *v.* Wells, 1 Rob. (N. Y.) 666.

[2] People *v.* Wemple, 117 N. Y. 136; *s. c.* 6 L. R. A. 303; 27 N. Y. State Rep. 341; 7 Rail. & Corp. L. J. 127; 22 N. E. Rep. 1046; 2 Inters. Com. Rep. 735; 29 Am. & Eng. Corp. Cas. 610; affg *s. c.* 52 Hun (N. Y.), 434; 24 N. Y. State Rep. 668; 5 N. Y. Supp. 581.

[3] Hoadley *v.* County Commissioners, 105 Mass. 519.

[4] Oliver *v.* Liverpool &c. Ins. Co., 100 Mass. 531; *s. c.* affirmed, 10 Wall. (U. S.) 566; *ante*, § 3. While this is so, it has been held in Massachusetts that the statutes of another State authorizing the formation of joint-stock companies, with the incidents usual to corporations, and providing that they may be sued in the name of their president or treasurer, and that a judgment, rendered against such an officer in the name of the company, cannot form the basis of a demand against the individual members

§ 2807. Taxation of an Unauthorized Over-issue of Shares.— Under a statute providing that no tax shall be assessed upon the capital of any bank or banking association, but that the stockholders shall be assessed and taxed on the whole of their shares of stock therein,[1] it has been held that, in case of an unauthorized or *ultra vires* excess of stock, the State cannot maintain a bill in equity against the corporation or its managing officers for a recovery of the taxes assessed against the corporation in respect of such shares, since the cause of action is not against the individual owners of such over-issue of shares; but even if the assessment were then against them individually, it would be necessary for them to be *parties* to the suit.[2]

Article II. Double Taxation in Respect of Shares.

§ 2810. Distinction Between Capital and Shares.— At the outset it is necessary to recur to the distinction already stated[3] between corporate capital, or corporate franchises, or corporate property, on the one hand, and corporate *shares*, on the other. We have seen[4] that the shareholders are not part owners of the

until execution against the company is returned unsatisfied — are local in their operation, so far as regards legal remedies for debt in Massachusetts; but the members may there be sued as partners. Taft *v.* Ward, 106 Mass. 518. See further as to the *status* of the members of such associations, as partners in Massachusetts: Tappan *v.* Bailey, 4 Met. (Mass.) 529; Tyrrell *v.* Washburn, 6 Allen (Mass.), 466.

[1] Thomp. & S. Tenn. Code, § 541c.

[2] State *v.* Butler, 86 Tenn. 614, 632; *s. c.* 8 S. W. Rep. 586.

[3] *Ante,* § 1065, *et seq.*

[4] *Ante,* § 1071

corporate property either at law or in equity; but that the title of all the corporate property is vested in the ideal being which acts through the board of directors, and other officers, under the corporate name.[1] From this it follows that the taxation of the *capital* owned by an incorporated bank, returned in gross by its president in pursuance of a revenue law, is not deemed a taxation of the *shares* of stock of the bank. The shares of stock are deemed the property of the individval shareholders,[2] and are in the nature of *credits* based upon the existing capital of the bank. Confusion has sprung up in dealing with this subject from the use of the word "stock" to designate, on the one hand, the capital stock of the company, and, on the other hand, the shares of its members. This stake, subscribed for and paid in or secured, upon which the corporation embarks upon its business, is its capital stock. The collection of rights in its capital stock, in its management and in its profits, known as its "shares," are sometimes called its "share stock," to distinguish this species of property from the capital stock. The two things are distinct kinds of property: the capital stock is exclusively the property of the corporation, while the share stock is exclusively the property of the stockholders.[3]

§ 2811. Taxation of Shares not a Taxation of Capital, and Vice Versa. — A leading proposition, then, is that the taxation of the *property* of a corporation is not a taxation of its *shares*, and *vice versa*. The present chapter is chiefly devoted to a consideration of the consequences which flow from the foregoing

[1] Reg. *v.* Arnand, 9 Ad. & El. (N. S.) 806; Van Allen *v.* Assessors, 3 Wall. (U. S.) 573, 584; Farrington *v.* Tennessee, 95 U. S. 679, 686; Porter *v.* Rockford &c. R. Co., 76 Ill. 561, 567; Delaware Railroad Tax, 18 Wall. (U. S.) 206, 229; Lee *v.* Sturges, 46 Oh. St. 153, 161; Bradley *v.* Bander, 36 Oh. St. 28, 35; *s. c.* 38 Am. Rep. 547; Conwell *v.* Connersville, 15 Ind. 150; McKeen *v.* Northampton County, 49 Pa. St. 519, 525; *s. c.* 88 Am. Dec. 515.

[2] St. Louis &c. Association *v.* Lightner, 42 Mo. 421.

[3] The distinction between these two species of property is thrown into clear light in the opinion of the Supreme Court of Ohio, delivered by Boynton, J., in Jones *v.* Davis, 35 Oh. St. 474, 476. The same distinction is, if possible, thrown into a clearer light, in an opinion of the Court of Appeals of New York, delivered by Finch, J., in People *v.* Coleman, 126 N. Y. 433, 437. It is clearly stated by Battle, J., in State *v.* Petway, 2 Jones Eq. (N. C.) 396, 406.

distinctions. One of them is—that *shares* of the stock of a corporation are taxable as such to their owners, though the corporation itself is *exempt* from taxation by its charter, — the capital being one thing and the shares another.[1] Another is—that although the capital stock of the corporation may be wholly *invested in bonds of the United States*, which are *exempt* from State taxation, the shares of stock in the corporation, in the hands of the individual shareholders, are nevertheless taxable.[2] A third is—that where a corporation duly returns its property for taxation under oath, in compliance with the governing statute, the assessors are not at liberty arbitrarily to disregard the return thus made, and to take the aggregate market value of the shares as the basis of assessing its property.[3] That the value of the corporate property may be ascertained for the purpose of taxation, in default of information furnished by the company, and in many cases irrespective of such information, has been often held.[4] The shares not being the property of the corporation, but of its members, may have a value greatly above or below the value of the property of the corporation. They may have a value depending upon the mere estimation, opinion, or belief which is entertained as to the future development and prospects of the corporation, or a value based upon mere speculative probabilities or contingencies, and which has but a remote relation to the actual value of the corporate property. It may also have a value based upon a manipulated market. It is further to be observed that, where the aggregate value of the shares is taken as the basis of assessing the corporate property for taxation, and where the shares are again assessed as the

[1] Union Bank *v.* State, 9 Yerg. (Tenn.) 490. But see *post*, § 2827, *et seq.*

[2] National Bank *v.* Commonwealth, 9 Wall. (U. S.) 353; St. Louis &c. Asso. *v.* Lightner, 47 Mo. 393; *post*, § 2827. Such a tax may also be collected from the bank. St. Louis Building Asso. *v.* Lightner, *supra.*

[3] That the "capital stock" of a corporation liable to taxation under N. Y. Laws 1857, chap. 456, § 3, is the actual capital owned by the corporation, and not the shares of stock: People *v.* Coleman, 126 N. Y. 433; 12 L. R. A. 762; 38 N. Y. St. 237; 27 N. E. Rep. 818; 10 Rail. & Corp. L. J. 188; 34 Am. & Eng. Corp. Cas. 223; reversing *s. c.* 36 N. Y. St. 221; 13 N. Y. Supp. 67.

[4] New Orleans Gas Light Company *v.* Board of Assessors, 31 La. An. 475; State *v.* Stonewall Ins. Co., 89 Ala. 335; *s. c.* 7 So. Rep. 753; 8 Rail. & Corp. L. J. 308.

property of their holders at their real value, this results in double taxation pure and simple,— that is to say, in the taxation of the property twice at exactly the same valuation. In short, the foregoing distinction leads irresistibly to the conclusion that the capital stock of a corporation cannot be taxed as the property of a shareholder,[1] and that the shares of a shareholder cannot be taxed as property of a corporation.[2]

§ 2812. View that Taxation of both Shares and Capital is not Double Taxation.— The conception that the capital stock of a corporation is one kind of property, belonging to one owner, and that the shares into which it is divided constitute a distinct kind of property, belonging to different owners, has led several of the courts to the conclusion that for the legislature to impose a tax upon the capital, franchises, or other property of a corporation, or upon all of them together, and another and sep-

[1] Thus, property of a mutual fire insurance company, although consisting of personalty, is taxable to the corporation and not to its members; for, although the members are policyholders, the interest which they have in the corporate property, unless they have a claim for loss, is not such an interest as is liable to taxation. Tripp *v.* Merchants' Mut. F. Ins. Co., 12 R. I. 435. Many decisions are found touching this question, which merely involve the construction of statutes, and generally a comparison of different statutory provisions enacted within the same jurisdiction at different periods. They are, therefore, without value as materials of jurisprudence, and are merely noted in foot-notes in their appropriate places. Of this character is a decision in New Jersey holding that the repeal of a prior statutory system left the shares held by individual members of corporations subject to taxation; whereas they were previously exempt. State *v.* Jersey City, 45 N. J. L. 480. In the same category may be put a decision of the Supreme Court of Louisiana to the effect that the paid-up capital stock of the New Orleans Gas Light Company is subject to assessment and taxation, like any property of that corporation; the value of such stock to be ascertained from the market price, or in any other manner. New Orleans City Gas Light Co. *v.* Assessor, 31 La. An. 475. So, a decision of the Supreme Court of Ohio, holding that under certain statutes of that State an owner of shares is not required to list them for taxation, seems to possess little juridical value, because the statute in express terms so provides; although the opinion embodies a clear exposition of the difference between corporate capital and shares, which we have already quoted. Jones *v.* Davis, 35 Ohio St. 474.

[2] This distinction between capital and shares for the purposes of taxation is taken by Turley, J., in Union Bank of Tennessee *v.* State, 9 Yerg. (Tenn.) 490, 501; and is also recognized in St. Louis &c. Asso. *v.* Lightner, 42 Mo. 421

arate tax upon the shares assessed against the shareholders personally, either directly or through the corporation,— is not double taxation. Possibly there is no case that affirms this principle in as broad a manner as that stated in the foregoing proposition; but there are several affirming it in some of its essential parts. Thus, the Supreme Court of Tennessee has held that the fact that a tax has been assessed upon the capital stock of a moneyed corporation, and paid, does not preclude a tax upon the shares of stockholders.[1] The same court has held, under a statute, that joint-stock corporations are liable to pay the tax imposed upon their shareholders and collected through the company, and also a tax upon their real estate, although the latter may have been purchased with money paid in as capital stock.[2] In a later case the same court, taking a seeming distinction between the tangible property of a corporation and its capital stock, held that taxation of shares of corporate stock in the hands of stockholders, as their individual property, is not unconstitutional as constituting double taxation because a tax has already been laid upon the property of the corporation from which the capital stock in the hands of the corporation is omitted.[3] In other words, the court held that the tangible property of a corporation in which its capital has been invested may be taxed, and that the shares of its members may also be taxed, and the latter tax collected through the corporation.[4] So, in North Carolina it is said to be settled law that the shares of an individual shareholder are personal property, which are deemed to follow the owner, and which are hence subject to taxation as personal estate at the place of his residence; and this although the property and franchises of the corporation are also separately taxed, and although this results in a double taxation.[5] In Iowa it has been held that the legislature may authorize the taxation of the prop-

[1] Memphis *v.* Ensley, 6 Baxter (Tenn.), 553; *s. c.* 32 Am. Rep. 532.

[2] Nashville Gas Light Co. *v.* Nashville, 8 Lea (Tenn.), 406.

[3] Street R. Co. *v.* Morrow, 87 Tenn. 406; *s. c.* 2 L. R. A. 853; 5 Rail. & Corp. L. J. 248; 11 S. W. Rep. 348.

[4] So also held in Union Bank *v.* State, 9 Yerg. (Tenn.) 490. So *said* by Swayne, J., in Farrington *v.* Tennessee, 95 U. S. 679, 687.

[5] Belo *v.* Forsyth County, 82 N. C. 415; *s. c.* 33 Am. Rep. 688; Worth *v.* Ashe County, 82 N. C. 420; *s. c.* 33 Am. Rep. 692. See also Porter *v.* Rockford &c. R. Co., 76 Ill. 561; Danville &c. Co. *v.* Parks, 88 Ill. 170.

perty of the corporation,— *e. g.*, a toll bridge,— against the corporation, and a taxation of the shares of stock of the corporation against the stockholders.[1]

§ 2813. Contrary View that the Taxation of both Capital and Shares is Double Taxation.— Opposed to the foregoing is a line of judicial decisions, some of them dealing with the subject on principle, and some of them more or less influenced by the language of statutes and constitutional provisions, which unite in the conclusion that where a tax is laid upon the property of the corporation, whether under the name of capital or in the form of a tax upon the tangible property into which its capital has been transmuted, — another tax assessed against the shareholders upon the shares held by them of the capital stock of the corporation, is double taxation and not permissible.[2] So, in respect of *national banks*, where the statute of a State imposes upon *the State banks* a tax on their *capital* (the *shares* in the hands of their shareholders being *exempt* from taxation), it cannot lay a tax on the shares of national banks organized under the act of Congress of June 3, 1864, which provides: "That

[1] Cook *v.* Burlington, 59 Ia. 251; *s. c.* 44 Am. Rep. 679. Adams, J., concurred specially on the peculiar facts of the case. That double taxation has not been favored by that court is shown by several of its expressions. In Tallman *v.* Butler County, 12 Ia. 531, 534, it was said that "it is neither the policy nor the justice of the law to tolerate double taxation." In United States Express Co. *v.* Ellyson, 28 Ia. 370, 378, it was said that "double taxation would be so unjust as to excite disfavor of both courts and legislature." See also McGregor *v.* Vaupel, 24 Ia. 436.

[2] Gillespie *v.* Gaston, 67 Tex. 599; *s. c.* 4 S. W. Rep. 248; San Francisco *v.* Spring Valley Waterworks, 63 Cal. 524 (prior to Const. of 1879). The tax cases, 12 Gill. & J. (Md.), 117 (no opinion); Bordon *v.* Baltimore, 5 Gill. (Md.) 236 (doctrine recognized); The Republic Life Ins. Co. *v.* Pollak, 75 Ill. 292, 300 (recognized as pro hibited by statute); Porter *v.* Rockford &c. R. Co., 76 Ill. 561, 572 (not presumed to have been intended); Pennsylvania Co. *v.* Com. (Pa.), 13 Cent. 486; *s. c.* 46 Phila. Leg. Int. 300; 15 Atl. Rep. 456; 22 W. N. C. 340 (not officially reported — construing statutes); State *v.* St. Louis &c. R. Co., 77 Mo. 202; Valle *v.* Zeigler, 84 Mo. 214; Middlesex R. Co. *v.* Charlestown, 8 Allen (Mass.), 330; American Bank *v.* Mumford, 4 R. I. 478; Providence Institution *v.* Gardiner, 4 R. I. 484. In the Appeal of Des Moines Water Co., 48 Ia. 324, 336, it was held that where a statute authorizes the assessment of the property of corporations the same as that of individuals, and also the assessment of the shares of stock to the individual owners, taxation *under either method* is legal, but whether under both the court left undecided.

nothing in this act shall be construed to prevent all the shares in any of the said associations, held by any person or body corporate, from being included in the valuation of the personal property of such person or corporation in the assessment of taxes imposed by or under State authority, at the place where such bank is located, and not elsewhere, but not *at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State; provided, further, that the tax so imposed under the laws of any State upon the shares of any of the associations, authorized by this act, shall not exceed the rate imposed upon the shares in any of the banks organized under the authority of the State where such association is located; provided,* also, that nothing in this act shall exempt the real estate of associations from either State, county, or municipal taxes, to the same extent, according to its value, as other real estate is taxed." [1]

§ 2814. An Intent to Impose a Double Tax not Imputable to the Legislature. — Other decisions will be met with which, construing more or less doubtful statutes, refuse to impute to the legislature the purpose of taxing at once the tangible property of a corporation and its intangible representative, the shares held by its members. One such case observes that "a taxation of shares at their appraised value would, in fact, be a double taxation of the property, once to the corporation itself, and again to the corporators, which would be unjust, oppressive, and unconstitutional." [2] So, a case in Pennsylvania, officially reported, dealing with this subject, as involved in the construction of certain statutes, contains this observation in the opinion of the court by Paxson, J.: "Conceding the power of the legislature to tax in this manner, its exercise is never to be presumed. The intent to impose double taxation must be clearly expressed." [3] A statute of Indiana prohibits such taxation in explicit terms:

[1] Van Allen *v.* Assessors, 3 Wall. (U. S.) 573, 577; Bradley *v.* People, 4 Wall. (U. S.) 459 (reversing *s. c. sub nom.* People *v.* Bradley, 39 Ill. 130).

[2] Smith *v.* Burley, 9 N. H. 423, 427.

[3] Pennsylvania Co. *v.* Com. (Pa.), 15 Atl. Rep. 456; *s. c.* 22 W. N. C. 340. Similarly, Lenawee County Savings Bank *v.* Adrian, 66 Mich. 273, 276, per Campbell, C. J.; Porter *v.* Rockford &c. R. Co., 76 Ill. 561, 572; State *v.* St. Louis &c. R. Co., 77 Mo. 202, 210; Valle *v.* Zeigler, 84 Mo. 214; Ogden *v.* St. Joseph, 90 Mo. 522; American Bank *v.* Mumford, 4 R. I. 478, 483, per Bosworth, J.

"In all cases where the tangible property or the capital stock of any incorporated company is listed and assessed under this act, the shares of capital stock of such incorporated company shall not be listed and assessed."[1] In Texas the same conclusion is reached as a construction of the statute providing that "no person shall be required * * * to include in his statement, as a part of his personal property, which is required to be listed, any share or portion of the capital stock or property of any company or corporation which is required to list or return its capital and property for taxation."[2] A comparison of statutes of Rhode Island led to the conclusion that where the personal property of a corporation is taxed as such, the shares are not to be taxed, and *vice versa*.[3] Authoritative text-writers are to the same effect. Mr. Justice Cooley, in his work on taxation, says: "A construction of the law is not to be adopted that would subject the same property to be twice charged for the same tax, unless it was required by the express words of the statute, or by necessary implication."[4] It was entirely consistent with this theory to hold that where there was a statute providing that "the property of manufacturing companies * * * and of all other corporations, the taxation of which is not otherwise provided for by law, shall be assessed and taxed as the property of individuals,"—shares of stock held by an individual in a corporation are not subjected to taxation against the shareholder, under the terms of a general statute which goes no further than to subject "all personal property" to taxation.[5]

§ 2815. Taxing the Difference between the Value of the Tangible Property and the Value of the Shares.— The schemes of taxation established by several of the States aim at an equitable result by assessing against the corporation the actual value of its tangible property, and by assessing against its shareholders the aggregate value of its shares, after deducting the assessed

[1] R. S. Ind. 1881, § 6308.

[2] Rev. Stat. Tex., Art. 4682; Gillespie *v.* Gaston, 67 Tex. 599.

[3] American Bank *v.* Mumford, 4 R. I. 478, 483.

[4] Cooley Tax., 227. To the same effect see Burr. Tax., 174.

[5] Valle *v.* Ziegler, 84 Mo. 214, 219.

valuation of tangible property. A little reflection will make it appear that the corporation may have *franchises* or *business possibilities* which give a much greater aggregate value to its shares than the full value of all its tangible property; so that this scheme of taxation is, in substance and effect, a tax, first on the property of the corporation, and then upon its franchises, — the latter tax assessed against its shares in the hands of its shareholders. The Supreme Court of Kansas has made it appear in a very clear and well-reasoned opinion, that this mode of taxation is not open to any constitutional or other objection leveled against what is called double taxation; — in other words, that it is not double taxation at all, because the same property is not twice taxed by the same taxing power.[1] The constitution of Illinois provides that property shall be taxed in proportion to its value, and empowers the legislature to tax corporations as it sees fit, by general laws, uniform as to the class upon which they operate.[2] A statute of Illinois has enacted that all property in that State shall be taxed, including shares of capital stock, — such capital stock, including franchise, to be so valued as to ascertain its full cash value over and above the assessed value of the tangible corporate property, and that where the corporate property or the capital stock is taxed, the shares shall not be taxed.[3] Construing these provisions, the Supreme Court of that State say: "The tangible property of a corporation and the shares of stock are separate and distinct kinds of property, under different ownerships, the first being the property of the corporation, and the last named is the property of the individual stockholders, both of which, under the provisions of the revenue law, being subject to taxation." And the court held that this scheme of taxation was neither double nor unconstitutional.[4] It has been provided by statute in North Carolina that all property in the State, including shares of stock, shall be taxed; but that the shares of a corporation shall not be listed if the corporation

[1] Ryan *v.* Leavenworth County, 30 Kan. 185.

[2] Ill. Const., 1870, Art. IX., § 1.

[3] Ill. Act, March 30, 1872; *Id.*, May 13, 1879; Rev. St. Ill., 1874, ch. 120.

[4] Danville &c. R. Co. *v.* Parks, 88 Ill. 170. So held in Porter *v.* Rockford &c. R. Co., 76 Ill. 561. Compare Danville &c. Co. *v.* Parks, 88 Ill. 170; Republic Life Ins. Co. *v.* Pollak, 75 Ill. 292.

itself pays a tax.[1] Notwithstanding this statute, the supreme court of that State have said that " shares of stock in a corporation may be taxed as a distinct species of property belonging to the holder, independently of the tax imposed upon the value of the franchies and upon the real and personal estate of the corporation itself,"[2]— a decision which seems directly opposed to the statute.[3]

§ **2816. The Same Subject Continued.** — It is provided by statute in Louisiana, with reference to the taxation of banks, that "all property owned by the bank * * * which is taxable under section 1 of this act, shall be assessed directly to the bank, * * * and the *pro rata* of such direct property taxes, and of all exempt property, proportioned to each share of capital stock, shall be deducted from the amount of taxes assessed to that share, under this section."[4] The Supreme Court of Louisiana deny that, under the terms of this law, all the exempt property of the bank should be deducted in ascertaining the taxable valuation of the shares; and, secondly, that so much of its property as is invested in non-taxable securities, whether of the United States or of the State, should be thus deducted. They discover in the legislature the intent to tax such shares, though the capital of the bank may be invested in non-taxable securities.[5] A like scheme of taxation has existed in North Carolina, the statute permitting stockholders, in valuing their shares, to "deduct their ratable proportion of taxes paid by the corporation upon its property as such in this State."[6] In construing this statute, the Supreme Court of North Carolina found it difficult to say whether the value of the stock was to be reduced by the value of the corporate property

[1] Battle Rev. N. C. Stat., ch. 102, § 7.

[2] Belo *v.* Commissioners, 82 N. C. 415; *s. c.* 33 Am. Rep. 688.

[3] Unfavorable comments on this decision will be found in a learned article by Edward C. Moore, Esq., in 18 Am. Law Rev., 758, to which article the author acknowledges his indebtedness for valuable suggestions.

[4] As quoted in First National Bank *v.* Board of Reviewers, 41 La. An. 181, 184.

[5] First National Bank *v.* Board of Reviewers, 41 La. An. 181, 184; reaffirmed in Board of Liquidation *v.* Thoman, 42 La. An. 605.

[6] N. C. Act 1881, ch. 117, § 8, par. 6.

taxed, and a tax levied upon the difference, or whether the tax laid upon the property was to be abated to the extent of the tax laid upon the shares; but they concluded the latter to be the meaning. In the opinion of the court, which is somewhat obscure, it was the purpose of the statute to allow the tax-paying shareholder to deduct from the tax on his shares a ratable part of the tax paid upon the corporate property elsewhere, by the corporation itself, but not to withdraw from taxation in other counties such property of the corporation therein as was liable to assessment and taxation. The difficulty with the court seems to have been to determine whether the abatement was to be made upon the tax laid against the corporation in the county where it had its *situs*, or whether it was to be made upon the tax levied by the several counties distributively through which its road passed; and the court took the former view.[1] In New York, under the provisions of the statute "authorizing the taxation of the stockholders of banks,"[2] etc., the actual, and not the par value of the shares of capital stock of national banks was the basis of assessment and taxation; and it was the duty of the assessors to ascertain the actual value of the shares held by the stockholder, and after deducting his proportion of the real estate owned by the bank, to assess the tax upon the remainder.[3]

§ 2817. When a Tax upon Shares is Deemed a Tax Against the Corporation.— There is often much difficulty in determining whether a tax laid in the form of a tax upon share capital, but assessed against the corporation and collected from it, is a tax upon the corporation or upon the shares of its members. As elsewhere seen, the mere fact that the tax is in form assessed against the corporation does not prevent it from being regarded as a tax upon its individual members, in respect of their several holdings of shares; since it is competent for the legislature to make the corporation a sort of public agent, so to speak, for the collection of the tax. Where the corporation is given a lien

[1] Raleigh &c. R. Co. *v.* Wake County, 87 N. C. 414, 427.

[2] New York Laws of 1886, ch. 861.

[3] People *v.* Commissioners, 67 N. Y. 516; following People *v.* Commissioners, 4 Wall. (U. S.) 244, and Van Allen *v.* Assessors, 3 Wall. (U. S.) 573, so far as Federal questions were involved.

upon the shares of its members to reimburse itself in respect of the tax, or when it is given any other legal remedy against its members distributively, to recover the tax which it has paid for them, then it may be safely assumed that the legislature enacted it as a tax upon the shares in the hands of their holders distributively, though collected, as an aggregate sum, from the corporation itself in the first instance. On the other hand, where the legislature, in designating the character of a tax, uses the words "capital stock" without further explanation, it is not only to be held not to mean "shares of stock," either separately or in the aggregate, but it is reasonably assumed that the legislature, by the use of an apt phrase, intended to designate the property of the corporation as the subject of the tax.[1] In other cases, the mere fact that the tax is laid in form upon the shares does not deprive it of the quality of a tax against the capital of the corporation, and make it a tax against the shares in the hands of their holders. This is illustrated by an important case in which the legislature of Delaware passed an act providing that every railroad and canal company of a designated class should, in addition to other taxation, also pay to the treasurer of the State, for its use, on the first day of July then next, and on the first day of July of every year thereafter, or within thirty days from such period, a tax of one-fourth of one per cent upon the actual cash value of every share of its capital stock; with the proviso that, when the line of railroad or canal belonging to the company liable to the tax should lie partly within the State and partly within an adjoining State or States, the company should only be required to pay the tax on such number of the shares of its capital stock as would be in that proportion to the number of shares which the length of the road or canal within the limits of the State should bear to its whole length. It was held that this tax was not imposed upon the shares of the individual shareholders, or upon the property of the corporation, but that it was a tax upon the corporation itself, measured by a percentage upon the cash value of a certain proportional part of the shares of its capital stock; in other words, that it was what other courts have often designated as a *franchise tax*. The court also regarded

[1] Porter *v.* Rockford &c. R. Co., 76 Ill. 561.

the rule by which the tax was measured as approximately just, although arbitrary, and hence one which the legislature of a State is at liberty to adopt. In the opinion of the court, Mr. Justice Field, among other things, said: "The State may impose taxes upon the corporation as an entity existing under its laws, as well as upon the capital stock of the corporation or its separate corporate property. And the manner in which its value shall be assessed and the rate of taxation, however arbitrary or capricious, are mere matters of legislative discretion. It is not for us to suggest in any case that a more equitable mode of assessment or rate of taxation might be adopted than the one prescribed by the legislature of the State; our only concern is with the validity of the tax; all else lies beyond the domain of our jurisdiction." [1] The stress of the question lay in the proposition advanced in opposition to the tax, and impliedly conceded by the court, that if such were the character of the tax, it was beyond the power of the State to lay it, since it was beyond the power of the State to lay a tax upon personal property, the *situs* of which was beyond its territorial boundaries.[2]

§ **2818. Further of this Subject.**— In many cases such taxes are described in the statutes imposing them, as taxes upon the *capital* of the corporation, in all which cases there is no difficulty, in the absence of special elements in the statute, in concluding that a tax upon the shares distributively was not intended. In other cases the statute, after imposing a tax upon the capital, makes its meaning more clear, by way of contrast, by providing that the shares shall not be taxed where the capital is taxed. Such was the following statute of Illinois, which was held to be a tax upon the capital of the company, and not a tax upon the shares of its stock:[3] "The capital stock of all companies and associations, now or hereafter created under the laws of this State, shall be so valued by the State board of equalization as to ascertain and determine, respectively, the fair cash value of such capital stock, including the franchise, over and above the assessed value of the tangible property of such com-

[1] The Delaware Railroad Tax, 18 Wall. (U. S.) 206, 231.

[2] See on this question, *post*, §2846.

[3] State Railroad Tax Cases, 92 U. S. 575, 603.

pany or association. Said board shall adopt such rules and principles for ascertaining the fair cash value of such capital stock as to it may seem equitable and just; and such rules and principles, when so adopted, if not inconsistent with this act, shall be as binding and of the same effect as if contained in this act, subject, however, to such change, alteration, or amendment, as may be found from time to time to be necessary by said board: *Provided*, that in all cases where the tangible property or capital stock of any company or association is assessed under this act, the shares of capital stock of any such company or association shall not be assessed or taxed in this State. This clause shall not apply to the capital stock, or shares of capital stock, of banks organized under the general banking laws of this State." Although one court has held that an assessment of the aggregate value of the share capital of a company is an erroneous basis of assessment,[1] yet the Supreme Court of the United States has held, under the statute above quoted, that a basis of assessment which includes the market or fair cash value of the shares of capital stock of a company, and which provides for the taxation of its franchise or business possibilities or opportunities under its charter, and for the deduction from its aggregate value of the value of its tangible property, is not only not a tax against the shares distributively, but is a tax against the corporation, founded on perhaps as just and equitable a basis as could be devised.[2]

§ 2819. Rule how Affected by Default of Corporation or Shareholders.— On the one hand, it has been held that the mere fact that a corporation fails to make a return of its property to the tax assessor, as required by the statute, does not authorize the assessor to lay an assessment against the shares of the stockholder in the corporation, where so to do might create a double taxation contrary to the provisions of the statute.[3] On the other hand, if the tax assessor, proceeding in violation of such a statute, does lay an assessment against the shares of a stockholder, and afterwards lays an assessment, such as is authorized by law,

1 People *v.* Coleman, 126 N. Y. 433.

2 State Railroad Tax Cases, 92 U. S. 575, 604.

3 Gillespie *v.* Gaston, 67 Tex. 599.

against the property of the corporation, the latter cannot, in a proceeding to set aside the assessment against *its* property, set up the fact that the illegal assessment has been made against the shareholder. Here it was reasoned that while, under the terms of the statute, the shareholders could not be legally assessed on their shares, yet if they listed such shares for assessment it was their own fault. "They could, if they so desired, have avoided such a tax. * * * But, even if they did not, it concerns themselves alone, and in no wise affects the appellants [the corporation], who can only see to the taxes levied on the corporation."[1] The principle of these two decisions is, that the shareholder cannot, on the one hand, be deprived of his legal rights by the misprision or default of the corporation; and that the corporation cannot, on the other hand, acquire an advantage against the State in consequence of the error or neglect of its shareholders.

Article III. Exemptions from Taxation.[2]

[1] Republic Life Ins. Co. *v.* Pollak, 75 Ill. 292, 300.

[2] See also *post*, Ch. 121.

§ 2823. No Presumption in Favor of Exemption from Taxation. — All judicial opinion appears to unite upon the proposition that where an exception or exemption from taxation is claimed, the intention of the legislature to except or exempt must be expressed in clear and unambiguous terms. "The exemption," it has been said, "must be shown indubitably to exist. At the outset every presumption is against it. A well-founded doubt is fatal to the claim. It is only where the terms of the concession are too explicit to admit fairly of any other construction that the proposition can be supported."[1] It has also been said that an intent to confer immunity from taxation must be clear beyond a reasonable doubt; for, as in case of a claim of grant, nothing can be taken against the State by presumption or inference.[2]

§ 2824. No Exemption From Taxation Under General Words in Statutes. — The doctrine elsewhere stated[3] that statutes under which exemptions from taxation are claimed should be strictly construed in favor of the State and against the party claiming the exemption, has led the courts, in several cases, to hold that a statute creating an exemption in general terms in favor of shareholders in corporations, the stock of which is separately taxed, or giving them a right to deductions to the extent of their proportions of any tax separately laid upon the capital or tangible property of the corporation, — does not extend to *resident shareholders in foreign corporations*. On the

[1] West Wisconsin R. Co. *v.* Supervisors, 93 U. S. 595; Tucker *v.* Ferguson, 22 Wall. (U. S.) 527; Lee *v.* Sturgess, 46 Oh. St. 153, 159.

[2] Delaware Railroad Tax, 18 Wall. (U. S.) 206; Kirtland *v.* Hotchkiss, 42 Conn. 426; *s. c.* 19 Am. Rep. 546; Cincinnati College *v.* State, 19 Ohio, 110; Vicksburg &c. Co. *v.* Dennis, 116 U. S. 665; Farrington *v.* Tennessee, 95 U. S. 679; Chicago &c. Co. *v.* Guffey, 120 U. S. 569; Portland &c. R. Co. *v.* Saco, 60 Me. 196; Lima *v.* Cemetery Association, 42 Ohio St. 123; *s. c.* 51 Am. Rep. 809.

[3] *Post*, Ch. 121.

other hand, the same principle, as already seen, requires that general words in statutes subjecting shares in corporations to taxation be held to extend to shares held by residents in the stock of foreign corporations. Proceeding upon these principles, the Supreme Court of Ohio, in a very fully considered case, have held, on the one hand, that the term "investments in the stocks" in a revenue statute extends to investments in the stocks of foreign corporations; and, on the other hand, that no exemption from taxation is created in favor of the holder of such investments by the following statutory provisions: "No person shall be required to include in his statement, as a part of the personal property, moneys, credits, investments in bonds, stocks, joint-stock companies or otherwise, which he is required to list, any share or portion of the capital or other property of any company or corporation which is required to list or return its capital and property for taxation in this State."[1] "No person shall be required to list for taxation any certificate of the capital stock of any company, the capital stock of which is taxed in the name of said company."[2] The court took the view that these provisions did not apply to shares of a foreign corporation, although the capital of such corporations is taxed in the State where located, and although the corporation has substantial property in Ohio on which it pays taxes to that State; nor did it apply to shares of a railroad company which had been formed by the consolidation of an Ohio company with companies of other States, notwithstanding the consolidated company paid taxes in Ohio on the portion of its property which was situated there.[3] In like manner, the Supreme Court of the United States, following the interpretation put upon the second statutory provision above quoted by the Supreme Court of Ohio in a previous decision, held that it did not apply to shares in a foreign corporation which paid taxes in Ohio on a portion only of its property situated within that State. The court reasoned that the statute referred only to those corporations which were required to return all, or substantially all, of their capital or property for taxation in Ohio. In the view of the court, there was no rule of

[1] Ohio Act of Apr. 5, 1859 (S. & C. 1438), § 3, sub. 9.

[2] *Ibid.*, § 59.

[3] Lee *v.* Sturges, 46 Ohio St. 153; *s. c.* 19 N. E. Rep. 560; Owen, C. J., and Dickman, J., dissenting.

interpretation by which the statute could be held to apply to corporations which listed only a small part of their property for taxes in that State; and the court added that "if the legislature had intended to allow an exemption in such a case, it could and would have expressed that purpose by words not admitting of doubt."[1] The previous decision of the Supreme Court of Ohio, which was regarded by the Supreme Court of the United States, as necessarily controlling the question, decided, with the statute in question in force, that the shares of resident holders of a foreign corporation are subject to taxation, although the capital and property of the corporation may be taxed within the State of its *situs*.[2] The Supreme Judicial Court of Massachusetts have rendered a decision of a similar character, though not professedly based upon the same theory of statutory construction. The court hold that the following provision in the statute does not, when the statute is read with its other applicatory provisions, and when the language of the statutes, prior to being collected in the revision, is taken into consideration,— create an exemption in favor of the shares of stock held by a resident of the commonwealth in a company organized under a statute of Massachusetts for the purpose of building a railroad in a foreign country: "Provided, that no taxes shall be assessed in any city or town for State, county, or town purposes, upon the shares in the capital stock of a corporation organized or chartered in the commonwealth paying a tax on its corporate franchises, under the provisions of chapter thirteen, for any year in which it pays such tax."[3] On the other hand, the Supreme Court of Vermont, adopting what seems to be a just and sensible rule of construction, though possibly at variance with the strict rule of construction under consideration, have held that shares of stock held by residents of Vermont in a banking corporation domiciled in Canada, are exempt from taxation under the following description in the statute: "Shares of stock in a corporation situated in another State, when all the stock of such corporation is taxed in such State, to the holders, whether residing within or

[1] Sturges v. Carter, 114 U. S. 511, 521, 522.

[2] Bradley v. Bauer, 36 Ohio St. 28; s. c. Am. Rep. 547.

[3] Pratt v. Street Com'rs., 139 Mass. 559, 564.

without such State, or when the corporation is taxed in such State for all its stock." The court, speaking through Tyler, J., say: "We think the word 'State,' employed in the statute, should be construed to mean a *foreign State*, as well as one of the United States. The statute was enacted for the relief and benefit of the stockholders; therefore, upon the reason of the law, shares of stock in a foreign corporation should be exempt, as well as those in a corporation located in one of the States of this Union." [1]

§ **2825. Nor Because of the Uniform Practice of Taxing Officers.**— The true construction of the statute will be upheld by the judicial courts, although the contrary has been the long and uniform construction of the statute by the taxing officers of the State, for it is a general maxim of law that *laches cannot be imputed to the State*. "The general principle is, that *laches* is not imputed to the government; and this maxim is founded, not in the notion of extraordinary prerogative, but upon a great public policy. The government can transact its business only through its agents; and its fiscal operations are so various, and its agencies so numerous and scattered, that the utmost vigilance would not save the public from the most serious losses, if the doctrine of *laches* can be applied to its transactions." [2] A just application of this principle would seem to prevent the application *against the State* of the maxim *communis error facit jus*. It has accordingly been held that the omission of the taxing officers of a State in previous years to lay assessments upon property, cannot control the duty imposed by law upon their successors, or the power of the legislature to tax property, or the legal construction of the statute under which an exemption from taxation is claimed.[3] Accordingly, it was held no error to strike out the following allegation in a petition setting up an exemption from taxation in respect of the shares held by the petitioner in

[1] Foster *v.* Stevens, 63 Vt. 165, 180, 184; *s. c.* 22 Atl. Rep. 78; followed in Bugbee *v.* Stevens, 63 Vt. 185; *s. c.* 22 Atl. Rep. 80.

[2] Story, J., in United States *v.* Kirkpatrick, 9 Wheat. (U. S.) 720, 735. To the same effect, see State *v.* Brewer, 64 Ala. 287; Delaware &c. Canal Co. *v.* Commonwealth, 50 Pa. St. 399.

[3] Vicksburg &c. R. Co. *v.* Dennis, 116 U. S. 665.

a foreign corporation: "Since the year 1852, the statutes of Ohio relating to the taxation of investments in stocks of corporations have been substantially the same as those in force on the day following the second Monday of April, 1886; and in all this period said statutes have been construed, not only by the people of the State of Ohio generally, but by the officers charged with the execution thereof, as not requiring the owners of shares of stock in railway corporations, the capital of which is divided into shares which are transferable by each owner without the consent of the other stockholders, and part of the line of the railway of which lies within the State of Ohio, to list the same for taxation, or authorizing the officers of said State to tax the same against the owner thereof; and that, at the time the property was required to be listed for taxation in 1886, there was no law of Ohio, as plaintiff believes and charges, which subjected such shares of stock to taxation in the hands of the owners thereof." The court, speaking through Spear, J., say that if it could be admitted that the long and uniform practice of the taxing officers of the State of allowing a certain exemption, could bind their successors as to the assessment of future taxes, it would result in lodging in the hands of the taxing officers the power of exemption which the legislature alone possesses, and which the legislature moreover possesses under the limitations rescribed in the constitution.[1]

§ 2826. Exemption of Shares Protected Under United States Constitution.— Exemptions of the *shares* of a corporation from taxation granted in their charters, and intended to attract the investment of capital in the corporate enterprise thus put on foot, are protected under that clause of the constitution of the United States which prohibits the States from passing laws impairing the obligation of contracts, equally with exemptions tended to a corporation as an artificial body; and any future shareholders, becoming such by succession to the shares of previous owners, may, of course, avail themselves of such an exemption. This is fairly illustrated by a case originating in North Carolina, soon after the Civil War. A railroad charter, granted in

[1] Lee *v.* Sturges, 46 Oh. St. 153, 155, 176; *s. c.* 19 N. E. Rep. 560.

1852, provided that all the company's property of every description should be exempt from any public charge or tax whatsoever for the term of 15 years; and that, thereafter the legislature might impose a tax not exceeding 25 cents per annum on each share of the capital stock held by individuals, whenever the annual profits shall exceed eight per cent. The Supreme Court of North Carolina held that, although the annual profits had never exceeded eight per cent, the legislature might, in 1869, authorize to be levied an *ad valorem* tax upon the franchise, rolling-stock, and real estate of the company. The charter was, in its view, a rough estimate rather than a contract.[1] But the Supreme Court of the United States reversed this decision on error, holding that the tax in question was in contravention of the clause of the Federal constitution above referred to, because it impaired the obligation of the contract established by the grant of the exemption and its acceptance by the adventurers.[2]

§ 2827. Whether an Exemption Granted to a Corporation Extends to the Shares in the Hands of the Shareholders.— The Supreme Court of the United States has held that a general exemption from taxation granted by the legislature to a corporation in its charter, inhibits a subsequent taxation of the shares of the corporation assessed against the shareholders; so that a subsequent act of the legislature laying such an assessment against the shares is unconstitutional, as impairing the obligation of the contract.[3] But this doctrine seems to be in a large measure overthrown by subsequent decisions of the same court, holding that the shares of the stockholders in national banking associations are taxable by the State in like manner with other personal property, although all the capital of the corporation itself may be invested in securities of the United States, so as to be exempt from State taxation.[4] The subject is complicated by a later decision of the supreme Federal tribunal, which holds that the charter of a bank granted by the legislature of a State,

[1] Raleigh &c. R. Co. *v.* Reid, 64 N. C. 155.

[2] Raleigh &c. R. Co. *v.* Reid, 13 Wall. (U. S.) 269, 270.

[3] Gordon *v.* Appeal Tex. Court, 3 How. (U. S.) 133; State *v.* Branin, 23 N. J. L. 484, 493.

[4] Van Allen *v.* Assessors, 3 Wall. (U. S.) 573; People *v.* Commissioners, 4 Wall. (U. S.) 244; National Bank *v.* Commonwealth, 9 Wall. (U. S.) 353.

providing that the bank "shall pay to the State an annual tax of one-half of one per cent on each share of the capital stock subscribed, which shall be in lieu of all other taxation," creates a contract between the State and the shareholders of the bank, which is impaired by a subsequent revenue law of the State imposing an additional tax upon the shares in the hands of the shareholders, so that the subsequent law is unconstitutional and void.[1]

§ 2828. An Exemption Expressed or Implied, of Corporate Capital, is an Exemption of the Shares.— Out of the forego-

[1] Farrington *v.* Tennessee, 95 U. S. 679. In the first case in which the Supreme Court of the United States dealt with the question, the court simply held that an exemption from taxation granted by the legislature of Maryland to certain banks, under the name of "banks," in an act extending their charters, upon a consideration to be performed by the banks,— extended by implication to the shares of the shareholders, so as to inhibit the legislature from subsequently imposing a tax upon such shares in their hands as individuals. Gordon *v.* Appeal Tax Court, 3 How. (U. S.) 133. Note the reasoning of Mr. Justice Swayne on pages 147 and 148. The last case can hardly be understood as a doctrinary reaffirmation of the first. The opinion, though forcibly written, is so illogical in its reasoning, and the authorities cited are so loosely and inconclusively thrown in, that it is difficult to say what the court does hold, beyond an obvious misreading of the statute creating the exemption; and the judgment is weakened by the fact that three of the judges, Strong, Clifford and Field, dissented. The majority opinion proceeds upon the view that the following exemption, granted by the legislature of the State of Tennessee to the Union & Planters' Bank of Memphis, was intended to operate as an exemption of the shares of its stock in the hands of its shareholders, considered as their individual property, and not merely as an exemption of the capital stock of the corporation in its hands, or of its other property: "Said company shall pay to the State an annual tax of one-half of one per cent on each share of the capital subscribed, which shall be in lieu of all other taxation." The minority regard it as at least doubtful whether the statute was intended by those who enacted it to operate as an exemption in favor of the shareholders in respect of their shares, considered as their individual property, and they plant themselves upon the principle that where the question of an exemption from taxation is in doubt, it is, for the mere reason that there is doubt, to be decided in favor of the State and against the party claiming the exemption. They also take the view that the decision in Gordon *v.* Appeal Tax Court, 3 How. (U. S.) 133, is to be regarded as resting upon its own peculiar circumstances, and to be restrained to the peculiar facts there in judgment,— which is a round-about way of saying that a previous decision of the same court is repudiated or over-ruled. Farrington *v.* Tennessee, 95 U. S. 679, 694.

ing conceptions spring two opposing doctrines,— the one is that an exemption of the *capital* of a corporation, or of the *property* of a corporation in which its capital is invested, carries with it and involves an exemption of the *shares*, since the shares are merely the intangible representatives of the interest of each member in the property and franchises of the corporation.[1] This is not deemed by many of the courts inconsistent with the proposition stated in a preceding section,[2] that it is within the power of the legislature to provide for a taxation of both the capital of the corporation and the holdings of the individual shareholders; and some of the cases cited to the last proposition so hold.[3]

§ **2829. Illustrations.**— The charter of a bank, granted by the legislature of Tennessee, provided that *the bank* "shall pay to the State an annual tax of one-half of one per cent on each *share* of the capital stock subscribed which shall be in lieu of all other taxes." It was held: 1. That this provision was a contract between the State and the corporation, limiting the amount of tax on each *share* of the stock. 2. That a subsequent revenue law of the State, imposing an additional tax on the shares in the hands of stockholders, impaired the obligation of that contract, and was void.[4] - - - The charter of a railroad company, granted by the legislature of North Carolina, contains the following exemption: "All machines, wagons, vehicles and carriages, purchased as aforesaid with the funds of the company, and all other works constructed under the authority of this act, and all profits which shall accrue from the same, shall be vested in the respective shareholders of the company forever, in proportion to their respective shares, and the same shall be deemed personal estate, and shall be exempt

[1] Gordon *v.* Appeal Tax Court, 3 How. (U. S.) 133; Farrington *v.* Tennessee, 95 U. S. 679; reversing *s. c. sub nom.* Memphis *v.* Farrington, 8 Baxt. (Tenn.) 539; State *v.* Union & Planters' Bank (Tenn.), 19 S. W. Rep. 758; State *v.* Hernando Insurance Co., *Ibid.;* State *v.* Bluff City Insurance Co. *Ibid.;* Worth *v.* Petersburg R. Co., 89 N. C. 301; Worth *v.* Seaboard &c. R. Co., 89 N. C. 310; State *v.* Branin, 23 N. J. L. 484; State *v.* Bentley, 23 N. J. L. 532; State *v.* Jones, 38 N. J. L. 83; Johnson *v.* Commonwealth, 7 Dana (Ky.), 338, 342; New Haven *v.* City Bank, 31 Conn. 108; The Tax Cases, 12 Gill. & J. (Md.) 117; Gordon *v.* Baltimore, 5 Gill. (Md.) 231.

[2] *Ante*, §2812.

[3] State *v.* Branin, 23 N. J. L. 484; Smith *v.* Burley, 9 N. H. 423; Franklin Co. Const. *v.* Deposit Bank, 87 Ky. 370, 382, per Bennett, J.

[4] Farrington *v.* Tennessee, 95 U. S. 679, reversing *s. c. sub nom.* Memphis *v.* Farrington, 8 Baxt. (Tenn.) 539.

from any public charge or tax whatsoever." Subsequently the legislature of that State passed a revenue statute containing the following provisions: "Every railroad or canal company incorporated under the laws of this State, and not liable to a tax upon the property of said company, or the shares therein, shall pay to the State a tax on the corporation equal to the sum of one per cent upon the gross receipts of said company."[1] "Every railroad and canal company incorporated under the laws of this State and doing business herein, and not liable to a tax upon the property of said company, or the tax before mentioned in this section, shall pay a tax of one per cent upon the actual cash value of every share of its capital stock, and the tax of twenty-five dollars per mile per annum, as a privilege tax, for the year 1881, required by the act of 1881, chapter 70, schedule C, section 1, to be paid in lieu of the last tax."[2] It was held that this statute, in so far as it sought to lay a tax upon the shares of a corporation, impaired the obligation of the contract created between the State and the shareholders by the charter provision first above quoted, and was hence unconstitutional and void.[3] - - - - The charter of a railroad company provided for a certain scheme of taxation against the company, and then concluded with the proviso "that no other tax or impost shall be levied or assessed upon *said company*." It was held that this proviso precluded the subsequent assessment of the *shares* of the company *in the hands of their individual owners*.[4]

§ 2830. Effect of Statutes Vesting the Corporate Property in the Shareholders According to Their Respective Shares.— Several of the legislative charters of railway companies, which contain this exemption in terms, vest the property of the corporation in its shareholders according to their respective shares, and then at the close exempt the whole from taxation. The following clause in the charter of the Petersburgh Railroad Company, granted by the legislature of North Carolina, is cited as an example of this: "All machines, wagons, vehicles and carriages, purchased as aforesaid with the funds of the company, and all other works constructed under the authority of this act, and all profits which shall accrue from the same, shall be vested in the respective shareholders of the company forever, in proportion to their respective shares, and the same shall be deemed personal estate, and shall be exempt from any public charge or tax whatsoever." It

[1] N. C. Act of 1876-77, ch. 156, schedule C, § 1.

[2] *Ibid.*, § 2.

[3] Worth *v.* Wilmington &c. R. Co., 89 N. C. 291; *s. c.* 45 Am. Rep. 679; Worth *v.* Petersburg R. Co., 89 N. C. 301.

[4] State *v.* Jones, 38 N. J. L. 83; following State *v.* Branin, 23 N. J. L. 484, and State *v.* Bentley, *Id.* 532.

cannot be supposed that, in using this language, the legislature intended to vest the corporate property in the shareholders in any other or different sense from the sense in which the property of any ordinary joint-stock corporation is vested in its shareholders. But it is a cogent argument, in determining the scope of the exemption from taxation thus created, that the legislature, in thus declaring in terms that the property of the corporation should be vested in its shareholders according to their respective shares, and then adding the exemption from taxation, intended to create an exemption from taxation in favor of the shareholders individually in respect of their shares, considered as their individual property; and it has been held that such was the purpose of the legislature in casting the exemption in this frame of language.[1] The legislature intended to make it clear that the property of the corporation should not be taxed, either as against the corporation, or as against the shareholders in the form of a tax on their shares.

§ 2831. Tangible Property of Corporations Exempt where the Tax is Laid upon the Shares. — According to some holdings, influenced in some cases by the provisions of statutes, the rule works the other way, so that where the tax is laid upon the aggregate shares of a corporation owned by its shareholders, — and especially if it is assessed and collected in form against the corporation, — this will operate to exempt from taxation the tangible property of the corporation, except in so far as taxation of such tangible property is expressly authorized. Such was the conclusion of the Supreme Court of Michigan, construing a collection of statutes of that State which plainly support the view taken by the court.[2] Such seems to have been the conclusion of the Supreme Judicial Court of Massachusetts, construing statutes of that State, and reaching the conclusion that a street railway company could not be taxed in respect of its specific property, or tangible property, where the governing scheme of taxation imposed a tax upon its shareholders in the aggregate. The court, speaking through Hoar, J., says: "The corporation has no residence. Its stockholders are liable to taxation upon their shares

[1] Worth *v.* Petersburg &c. R. Co., 89 N. C. 301, 309. Compare State *v.* St. Louis &c. R. Co., 77 Mo. 202, 207; Baltimore &c. R. Co. *v.* District of Columbia, 3 MacA. 122, where there was a similar charter provision.

[2] Lenawee County Sav. Bank *v.* Adrian, 66 Mich. 273; *s. c.* 18 Am. & Eng. Corp. Cas. 471; 33 N. W. Rep. 304; 9 West. Rep. 697.

in the towns where they dwell. The value of the personal property owned by the corporation is included as a subject of taxation in the value of the shares, — as in the case of banks, insurance companies, manufacturing corporations, and other railroads."[1] Such was the conclusion of the majority of the Supreme Court of Missouri in a case where the charter of a railroad company provided that "the capital stock, together with all machines, wagons, cars, engines, or carriages belonging to the company, together with all their works and other property, and all profits which shall arise from the same, shall be vested in the respective shareholders of the company forever in proportion to their respective shares, and the same shall be deemed personal estate and be exempt from any public charge or tax whatsoever for the period of five years after the passage of this act."[2] The revenue law in force when this period of exemption expired provided that, "for the support of the government * * * a tax shall be levied upon the following objects: * * * shares of stock in incorporated companies at their actual value, exempting manufacturing companies, the property of which alone shall be taxed; * * * all property owned by incorporated companies over and above their capital stock." It was held that this statute operated to exonerate the corporation from all taxation in respect of its property, except such as it owned over and above its capital stock. "The State could have taxed either the capital stock or the property of the corporation, and might have imposed the tax on the shareholders, or against the corporation, on the aggregate of its capital stock." Other sections of the revenue law of that State provided, as do the revenue laws of many other States, for an assessment of taxes against the shares of the stockholders, in form against the corporation, for the collection of such taxes from the corporation, and for giving the corporation a lien upon the shares for the taxes so paid. The court reasoned that this provision for assessing the aggregate shares was tantamount to a provision for assessing the capital stock of the company; and that it was hence not competent for the legislature thereunder to enact a so-called "back tax law," subjecting the tangible property of the

[1] Middlesex R. Co. *v.* Charlestown, 8 Allen (Mass.), 330, 333.

[2] Laws Mo. 1853, p. 323, sec. 6.

company to taxation for the years intervening between the expiration of the exemption and the passage of such back tax law. The contention that if the tax thus prescribed was a tax against the shareholders, the corporation had escaped taxation entirely, was answered by Henry, J., thus: "This argument overlooks the fact that, taxing the shares of individual stockholders is one way of taxing the property of the corporation. Taxing the shares against the stockholders, and also the capital stock, or the property represented by the capital stock, is duplicate taxation." [1] Such also was the view of the Supreme Court of Tennessee, that court holding that a bank charter providing that the bank "shall pay annually one-half per cent on each share of its capital stock, which shall be in lieu of all other taxes," exempts from taxation all realty owned and used by the bank exclusively for banking purposes.[2]

§ 2832. Contrary View that an Exemption of the Shares Does not Necessarily Exempt the Corporation.— The Supreme Court of New Jersey have lately arrived at the conclusion that the statutory exemption of the shares of a corporation from taxation does not necessarily exempt the corporation from taxation, even from the imposition of what is called a *franchise tax*,[3] which, as already seen, is a tax levied upon that ideal property consisting of *its business possibilities springing out of the exercise of its statutory privileges*, the value of which franchise is strictly represented in the value of its shares, in so far as those shares represent any value above that of its tangible property.[4] The court proceed upon the ground that a franchise tax cannot be said to be a tax upon the shares, so as to fall within the meaning of such an exempting statute. They also say that it does not follow from the doctrine laid down by them in previous cases,[5] that an enactment exempting a corporation or its property from "any other tax or impost" than the one specified, exempts also

[1] State *v.* St. Louis &c. R. Co., 77 Mo. 202, 209.

[2] State *v.* Butler, 86 Tenn. 614; *s. c.* 8 S. W. Rep. 586.

[3] *Post*, Ch. 120.

[4] State *v.* Heppenheimer, 24 Atl. Rep. 446.

[5] Referring to State *v.* Branin, 23 N. J. L. 484; State *v.* Bentley, 23 N. J. L. 532; State *v.* Powers, 24 N. J. L. 400. See also State *v.* Jones, 38 N. J. L. 83.

the shares of stock held by individuals, — that, therefore, *e converso*, the exemption of the shares must be held to exempt the company also. The opinion manifests an evident disposition to curtail the doctrine of those cases.[1]

§ 2833. Whether Preferred Stock Exempt from Taxation as Shares, or Taxable as a Credit.— A vicious feature of the revenue laws of many of the States, existing in New York, and at one time in California, is disclosed elsewhere in this chapter, when treating of State taxation of the shares of national banks,[2]— a system under which mere credits or investments are taxable in the hands of the creditor, without any deduction, and under which shares in corporations, which are merely another species of investment, are taxable in the hands of the shareholders, but subject to a deduction in respect of the tax which has been paid by the corporation. Such a system exists in Ohio, and under it it became a question, in a very thoroughly considered case, whether the certificates of *preferred stock* in a railroad company existing under the laws of Ohio, issued in pursuance of legislative authority, secured by a mortgage upon the road, and carrying a guaranteed dividend of eight per cent per annum, but without the right to vote at corporate elections, — were exempt from taxation as shares, on the ground that the tax was paid by the railroad company on its capital stock, or were taxable as mere credits in the hands of their holders. It is quite apparent from discussions which have preceded under this title, in regard to the nature of preferred stock and of interest-bearing or guaranteed stock,[3] that this was a question which might have been decided either way upon plausible grounds. The court, in a very well-considered opinion by Spear, J., while conceding the principle that exemptions from taxation are to be strictly construed

[1] State *v.* Heppenheimer, 54 N. J. L. 439; *s. c.* 24 Atl. Rep. 446, 448. So much of the clause of the charter as states the exemption is in the following language: "If and so long as the said corporation shall invest and keep invested in real estate within this State the sum of five hundred thousand dollars, the real and personal property of the said corporation not actually in fact within the State of New Jersey, and the stock of the said corporation held or owned by any of its stockholders, shall not be liable to any tax or impost whatsoever." 24 Atl. Rep. 447.

[2] *Post*, §§ 2862, 2863.

[3] *Ante*, § 2236, *et seq.*

against the party claiming the right of exemption, nevertheless, after tracing the chief characteristics of this species of corporate stock, concluded that it ought to fall within the category of shares which were not taxable, by reason of the fact that the tax had been paid by the corporation, and that they were not mere certificates of corporate indebtedness, which were taxable to their holders as credits.[1] The decision reaches the plain justice of the case, and prevents what would plainly be a *double taxation.*

§ 2834. Earnings Invested in Preferred Stock of Another Corporation Lose Their Exemption.— In successive charters of a railroad company there was an exemption from taxation which, in an amendatory act, stood in the following language: "The said railroad and all engines, cars, and machinery, and all the works of said company, together with all profits which shall accrue from the same, and *all the property thereof of every description*, shall be vested in said company, one-half thereof to the use and benefit of the State, and the other half to the use and benefit of the individual stockholders, and the same shall be deemed and held to be personal estate, and *shall be exempt from any public charge or tax whatsoever, for the term of fifteen years*, and thereafter the legislature may impose a tax not exceeding twenty-five cents per annum on each share of its capital stock held by individuals, whenever the annual profits shall exceed eight per cent."[2] The company enjoying this immunity purchased the preferred shares of another railway company, which it operated as a branch or feeder of its main line, which preferred shares were interest-bearing, and were secured by a mortgage upon the property of the other company. It was held that, although the branch line was an important adjunct of the company enjoying the exemption, the preferred shares were not exempt from taxation in its hands as their owner, under the head of profits or otherwise, under the statute above quoted. The theory of the court was that exemptions from taxation cannot be made to *grow* in this way.[3]

[1] Miller *v.* Ratterman, 47 Oh. St. 141; *s. c.* 23 Oh. L. J. 416.

[2] N. C. Act, 1852–53, ch. 140, § 8.

[3] Raleigh &c. R. Co. *v.* Wake, 87 N. C. 414, 418, 422.

§ 2835. Not Entitled to Reduction in Respect of Preferred Stock of Another Corporation, Under the Head of "Credit."— Where a railroad company was assessed in respect of a quantity of the preferred shares of another and connecting railroad company, of which the assessed company had become the proprietor, it was held that it was not entitled to have its assessment set aside on the ground that the preferred stock was in substance a *credit*, to be diminished by taking from the amount of the indebtedness of the company the amount of its outstanding bonds, by means of which the money was raised with which it purchased such preferred stock. The court held that this preferred stock, though held by the railroad company complaining of the assessment, as the guaranty of the payment of a semi-annual dividend or interest, was, nevertheless, essentially and truly *stock*, and not a *credit* to be set off and diminished by an outstanding indebtedness under a provision of a governing statute. The court reached this conclusion by a comparison of several clauses of the statute, showing what the legislature meant by the expression "solvent credits." [1]

§ 2836. Sinking Fund Deductible as a Credit.— Under a revenue law providing for a deduction of "solvent credits," it has been held that a railroad company is entitled to an abatement of an assessment laid against it to the extent of a *sinking fund*,— this being no more than a provision to meet a future debt, and as a credit being absorbed in the larger debt intended to be met.[2]

§ 2837. Deduction on Account of Real Estate Held in Other States.— Contrary to the strict rule of interpretation elsewhere suggested, a statute of Connecticut[3] that all the stock of insurance and various other corporations, owned by residents of the State, shall be set in their tax lists at their market value; but if any portion of the capital of the company is invested in any real estate upon which the company pays a tax, the assessed value of such real estate shall be deducted from the market value of the stock,— has been held to require a deduction of the

[1] Raleigh &c. R. Co. *v.* Wake, 87 N. C. 414, 423; *ante*, § 2236, *et seq.*

[2] Raleigh &c. R. Co. *v.* Wake, 87 N. C. 414, 427.

[3] Conn. Acts of 1877, Chap. 47.

assessed value of any real estate held by the company *in another State* upon which it pays a tax in such other State. The words "real estate," employed in the statute, are not understood as intended to be limited to real estate situated within the limits of the domestic State. In reaching this just and sensible interpretation of the statute, the court — as lawyers often do — hit upon the fanciful reason that the statute was not to be strictly construed in favor of the State because it was a statute of *exemption* and not a statute of *taxation*.[1] But it has been held that an assessment laid, in the State of Maryland, against the shares of non-resident stockholders in a Maryland corporation, was not rendered invalid by the circumstance that the corporation had certain real estate in the State of New Jersey, of the value of $150,000, used by it in the prosecution of its proper business, and that this valuation had been included in estimating the taxable value of its shares. The court took the view that the *situs* of the property of the corporation which formed an ingredient in estimating the value of the shares was wholly immaterial.[2]

§ 2838. Whether Exemption of Corporation Exempts Dividends of Shareholders.— It has been held that a clause in a bank charter limiting the tax which can be laid on its capital stock at so much per share, does not preclude the legislature from subsequently laying a tax upon *dividends* declared and set apart to the stockholders;[3] but this is a doubtful view, since a tax on the dividends has precisely the same result on the rights of the members of the corporation as an additional tax on the capital of the corporation would have.

§ 2839. An Exemption in Favor of Stock Attaches to a Lawful Increase of Stock.— It seems clear enough that an exemption granted to a corporation in general terms, from taxation upon its capital stock under given conditions, extends to any law-

[1] Batterson *v.* Hartford, 50 Conn. 558. The sum to be deducted, upon each share of stock in the list of a shareholder, should bear the same proportion to the market value of the shares that the entire investment in taxable real estate bears to the entire surplus of assets above liabilities. *Ibid.*

[2] American Coal Co. *v.* County Comrs., 59 Md. 185, 193.

[3] State *v.* Petway, 2 Jones Eq. (N. C.) 396, 406.

ful *increase* in such capital stock, authorized or contemplated by the legislature at the time of creating the exemption. This view is supported and illustrated by a case in North Carolina where the statute, in extending to a railroad company a certain exemption for a term of fifteen years, concluded thus: "And thereafter the legislature may impose a tax not exceeding twenty-five cents per annum on each share of its capital stock held by individuals, whenever the annual profits shall exceed eight per cent."[1] The railroad company had, prior to December 25, 1867, made an annual profit in excess of eight per cent, but had not made such a profit since that date. The company increased its capital stock from $975,000 to $1,500,000, and in 1871 declared a dividend of six per cent upon its total stock, as thus increased. It was contended on behalf of the tax commissioners that this six per cent dividend upon a stock of $1,500,000 showed that the annual profits for that year exceeded eight per cent, within the meaning of the statute,— their position being that the exemption extended only to a case where the annual profits did not exceed eight per cent upon the capital as originally fixed. But the supreme court overruled this contention.[2]

§ 2840. Shareholder not Entitled to Exemption because Corporate Funds Invested in Non-taxable Securities. — The rule established by the Supreme Court of the United States, in construing the provisions of the national banking act,[3] has grown, or possibly will grow, into a general principle of the law relating to the taxation of corporate shares, — namely, that the share-

[1] N. C. Act of 1852–53, ch. 140, § 8.

[2] Raleigh &c. R. Co. *v.* Wake, 87 N. C. 414, 425. The opinion was expressed that it was not the intent of the legislature that whenever, in any one year, the net receipts would admit of a dividend in excess of eight per cent, the condition of the exemption was fulfilled and forever extinguished; but that the meaning was that the tax could only be levied from time to time as often as the profits reached the limit, and that it could not be levied when they fell short of it. It was thought to be the meaning of the legislature to allow the tax only when the profits reached eight per cent, thus securing to the shareholder an interest or dividend to that extent on his investment, reducible only by the small tax allowed; otherwise the tax would be collectible when no profit whatever was made out of which it could be paid. But the court did not regard the point as necessary to be decided.

[3] Van Allen *v.* Assessors, 3 Wall. (U. S.) 573; cases cited in next note.

holder upon whose shares a tax is levied is not entitled to any exemption, abatement, or deduction, on the ground that the capital of the corporation, represented by its share certificates, has been invested in securities which are non-taxable, either under the Federal or the State law.[1]

Article IV. Situs of Shares for the Purpose of Taxation.

§ 2846. Jurisdiction Either of Person or Property Sufficient to Support the Right of Taxation. — In a case in Michigan this proposition is laid down: "A tax is a portion of the property of a citizen required by the government for its support in the discharge of its various functions and duties, and may be imposed when either person or property is within its jurisdiction. A personal tax cannot be assessed against a non-resident; neither can the property of a non-resident be taxed, unless it has an actual *situs* within the State, so as to be under the protection of its laws."[2] So in a case in the Supreme Court of the United States, it is said by Chief Justice Waite: "The power of taxation by

[1] Van Allen *v.* Assessors, 3 Wall. (U. S.) 573; People *v.* Commissioners, 4 Wall. (U. S.) 244; National Bank *v.* Commonwealth, 9 Wall. (U. S.) 353; Mercantile Bank *v.* New York, 121 U. S. 138; First National Bank *v.* Board of Reviewers, 41 La. An. 181; *s. c.* 5 South. Rep. 408; Board of Liquidation *v.* Thoman, 42 La. An. 605; *s. c.* 8 South. Rep. 482; Parker *v.* Sun Ins. Co., 42 La. An. 1172; *s. c.* 8 South. Rep. 618; Home Ins. Co. *v.* Board of Assessors, 42 La. An. 1131; *s. c.* 8 South. Rep. 481. Compare People *v.* Commissioners, 23 N. Y. 192; Batterson *v.* Hartford, 50 Conn. 558. A failure to deduct from an assessment against the shares of stockholders the value of exempt State and city bonds owned by the corporation does not amount to a tax on such bonds, and so does not violate La. Const., art. 203, which requires that taxation shall be equal and uniform, or the constitutional provision as to the obligation of contracts. Parker *v.* Sun Ins. Co., 42 La. An. 1172; *s. c.* 32 Am. & Eng. Corp. Cas. 334; 8 South. Rep. 618.

[2] Graham *v.* St. Joseph, 67 Mich. 652, 655.

any State is limited to persons, property, or business within its jurisdiction. Personal property, in the absence of any law to the contrary, follows the person of the owner, and has its *situs* at his domicile. But, for the purpose of taxation, it may be separated from him, and he may be taxed on its account at the place where it is actually located. These are familiar principles, and have been often acted upon in this court and in the courts of Illinois. If the State has actual jurisdiction of the person of the owner, it operates directly upon him. If he is absent, and it has jurisdiction of his property, it operates upon him through his property."[1] These quotations show that there are two theories, to either one of which a State may resort in taxing personal property, according to its necessities or its caprice: 1. The theory that a State has plenary power in respect of taxation over all property, fixed or movable, which has an *actual existence* within the limits of the State. 2. The *fiction* that movable property follows the person of the owner, and has a *situs* for the purposes of taxation wherever his legal domicile may be. These two theories open the road to one of the most frequent forms of *double taxation*, not only in respect of corporate shares, but also in respect of other personal property. For instance, a resident of Rhode Island owns shares in a manufacturing corporation existing in Massachusetts. The shares are taxed in Massachusetts in the form of a tax laid against the corporation, and the collection of the tax is coerced from the corporation. And yet, under this fiction that the *situs* of personal property for the purposes of taxation is the residence of the owner, the State of Rhode Island lays a tax upon the shares owned by the person named, and by exerting its process upon him, either by arresting his body or seizing his other property, coerces from him the payment of the tax, — which results in a double taxation of the same property; a taxation by each sovereignty, each proceeding upon the theory that the property is *within its own limits*. Both of these theories cannot be right. The *situs* of the property is either within the one State or in the other; and if it is within the one State, the other has no rightful power of taxation over it, but the power which it exerts is un-

[1] Tappan *v.* Merchants' National Bank, 19 Wall. (U. S.) 490, 499.

just, arbitrary, and tyrannical. It is exactly the same as though an individual proprietor of a cloth manufactory situated in Massachusetts should have his personal domicile in Rhode Island, and should have a million dollars' worth of manufactured cloths at his mills in Massachusetts, and the State of Rhode Island should assume the power to assess and coerce from him the payment of a tax upon those cloths, upon the fiction that movable property follows the owner.[1]

§ 2847. Corporate Shares Taxable at the Residence of Their Owners. — Corporate shares are *personal property;*[2] and the general rule, resting in a fiction of the common law, in regard to the *situs* of personal property, is that it *follows the residence of its owner.*[3] This rule applies to corporate shares, so that, where a different rule has not been established by statute, such shares are regularly taxable at the residence of their owner.[4] It follows that, unless the legislature has changed the rule, the shares of the stockholder cannot be listed for taxation at the place of residence of the corporation, that being different from the place of residence of the shareholder. Thus, the shares of stock in the Lawrence Gas, Coke & Coal Co. belonging to a shareholder who resided in Wakarusa township, and not in the city of Lawrence, could not be listed for taxation in the city of Lawrence.[5]

[1] As to this fiction, see further *post,* Ch. 201; and compare *ante,* § 2786.

[2] *Ante,* § 1066; Seward *v.* Rising Sun, 79 Ind. 351.

[3] McKeen *v.* Northampton, 49 Pa. St. 519, 525; *s. c.* 88 Am. Dec. 515.

[4] Conwell *v.* Connersville, 15 Ind. 150; Henkle *v.* Keota, 68 Iowa, 334, 340; Des Moines Water Co.'s Appeal, 48 Iowa, 324; Cook *v.* Burlington, 59 Iowa, 251; *s. c.* 44 Am. Rep. 679.

[5] Griffith *v.* Watson, 19 Kan. 23. By statute *in Missouri,* the owner of personal property which is subject to municipal taxation must deliver to the assessor a list thereof, with the cash value, stating in the list the property by classes, the sixth of which is: "The amount of stock or shares in any company or corporation not required by law to be otherwise listed." R. S. Mo. 1879, § 4701. The above principle applies in the application of this statute; so that a city of the second class in that State has power to tax shares of stock in a business corporation owned by a resident of such city, although the property of the corporation is outside the jurisdiction of the city, and cannot be taxed by it. Nor does it make any difference that the property of the corporation is situated in another State and taxable there. Ogden *v.* St. Joseph, 90 Mo. 522. Compare Rich *v.* Packard National Bank, 138 Mass. 527; Smith *v.* Burley, 9 N. H. 423.

§ 2848. Rule Applicable to Shares Held by Residents in Foreign Corporations.— So, there are many cases holding that where the legislature has not prescribed a different rule, the owner of shares of stock of a *foreign corporation* is liable to be taxed in respect of the shares in the *State of his residence*, on the theory that such shares are personal property which accompanies the owner wherever he goes.[1] It logically results from the foregoing proposition that shares in the stock of a foreign corporation are taxable in the hands of residents of the taxing State, although the tangible property of the corporation,[2] or even its aggregate *share capital*, is taxed in and by the State of its *situs*,[3] and even though the *particular shares* have been taxed as the property of the shareholder by the State of the *situs* of the corporation, and he has paid such tax.[4] A statute subjecting to taxation all the shares held by residents of the State in foreign corporations, or in particular kinds of corporations, extends to shares held by residents in foreign corporations:[5] the State having made no exception in favor of the holder of shares in such corporations, it is not for the courts to make any. In like manner, the owner of shares in a foreign corporation is

[1] Great Barrington *v.* County Commissioners, 16 Pick. (Mass.) 572; McKeen *v.* Northampton, 49 Pa. St. 519; *s. c.* 88 Am. Dec. 515; Whitesell *v.* Northampton, 49 Pa. St. 526; Dyer *v.* Osborne, 11 R. I. 321; *s. c.* 23 Am. Rep. 460; Ogden *v.* St. Joseph, 90 Mo. 522, 529; Worth *v.* Commissioners, 82 N. C. 420; *s. c.* 33 Am. Rep. 692; Worth *v.* Commissioners, 90 N. C. 409; Dwight *v.* Spingfield &c. Fire District, 11 Met. (Mass.) 374; Strong *v.* O'Donnell, 10 Phila. (Pa) 575; Graham *v.* St. Joseph, 67 Mich. 652; *s. c.* 12 West. Rep. 416; 35 N. W. Rep. 808; Bradley *v.* Bauder, 36 Oh. St. 28, 35; *s. c.* 38 Am. Rep. 547; State *v.* Branin, 23 N. J. L. 484; Newark City Bank *v.* Assessor, 30 N. J. L. 13; Worthington *v.* Sebastian, 25 Oh. St. 1, 9.

[2] McKeen *v.* Northampton, 49 Pa. St. 519; *s. c.* 88 Am. Dec. 515; Bradley *v.* Bauder, 36 Oh. St. 28; *s. c.* 38 Am. Rep. 547; Worthington *v.* Sebastian, 25 Oh. St. 1; Watson *v.* Spratley, 10 Exch. 236; State *v.* Branin, 23 N. J. L. 484; Newark City Bank *v.* Assessor, 30 N. J. L. 13; Sturges *v.* Carter, 114 U. S. 511, 521; Worth *v.* Commissioners, 82 N. C. 420; *s. c.* 33 Am. Rep. 692.

[3] Seward *v.* Rising Sun, 79 Ind. 351; Great Barrington *v.* County Com'rs, 16 Pick. (Mass.) 572; Bradley *v.* Bauder, 36 Oh. St. 28, 36; *s. c.* 38 Am. Rep. 547. Note the reasoning of the court in the last case on page 36 of the official report.

[4] Dyer *v.* Osborne, 11 R. I. 321; *s. c.* 23 Am. Rep. 460. Note especially the reasoning of the court in support of its conclusion, found on page 327 of the official report. Compare Trowbridge *v.* Com'rs, 5 Hun (N. Y.), 595.

[5] Great Barrington *v.* County Com'rs, 16 Pick. (Mass.) 572.

not entitled to a *deduction* from the tax upon his shares, by reason of a tax which may be laid upon the property of the corporation in the State wherein it is located.[1]

§ 2849. Legislature may Change this Situs and Tax Shares at Residence of Corporation. — But it is competent for the legislature to change the *situs* of shares for the purpose of taxation, so as to make all the shares of a corporation taxable at the place of residence of the corporation,[2] although this may draw (or keep) within the jurisdiction of the taxing State the shares held by *residents of other States*.[3] Thus, the legislature of a State may,[4] and often does, enact that all the shares of corporations created and doing business within the State shall be subjected to taxation at the *situs* of the corporation.[5] Nor is there much difficulty in upholding this power on legal theories; for, although the *situs* of the shares for most purposes, including that of taxation, where a different rule is not prescribed by statute, follows their owners,[6] yet the taxing power can be, and constantly is, exerted wherever *property* or *business* can be found within the jurisdiction, out of which the payment of the tax can be coerced. Besides, it is clearly competent for the State which has created the corporation to prescribe the condi-

[1] Dwight *v.* Boston, 12 Allen (Mass.), 316; *s. c.* 90 Am. Dec. 149. The rule has an analogy in regard to the taxation of debts secured by *mortgages* upon realty in another State. For the purpose of the taxation of such a chose in action, its *situs* is the domicile of the owner, and it may be taxed to the extent of its full value, notwithstanding the land itself may be also taxed to the same extent in the State where it is situated. Kirtland *v.* Hotchkiss, 42 Conn. 426; *s. c.* 19 Am. Rep. 546; *s. c.* affirmed 100 U. S. 491.

[2] *Ante*, § 2846; Tappan *v.* Merchants' Nat. Bank, 19 Wall. (U. S.) 490; Street Railroad Co. *v.* Morrow, 87 Tenn. 406; *s. c.* 2 L. R. A. 853; 5 Rail. & Corp. L. J. 248; 11 S. W. Rep. 348; First Nat. Bank *v.* Smith, 65 Ill. 44, 53; Danville &c. Co. *v.* Parks, 88 Ill. 170, 173. See also McLanglin *v.* Chadwell, 7 Heisk. (Tenn.) 389; Bedford *v.* Nashville, *Id.* 409; Nashville *v.* Thomas, 5 Coldw. (Tenn.) 500.

[3] Street Railroad Co. *v.* Morrow, *supra;* Baltimore *v.* Baltimore &c. R. Co., 57 Md. 31; American Coal Co. *v.* County Com'rs, 59 Md. 185, 192; St. Albans *v.* National Car Co., 57 Vt. 68, 81; Mortensen *v.* West Point Man. Co., 12 Neb. 197; *s. c.* 10 N. W. Rep. 432; Stockholders *v.* Supervisors, 88 Va. 293; *s. c.* 13 S. E. Rep. 407. *Contra*, as to taxing their dividends, see Oliver *v.* Washington Mills, 11 Allen (Mass.), 268.

[4] *Post*, §§ 2850, 2866.

[5] Baltimore *v.* Baltimore &c. R. Co., 57 Md. 31, 36.

[6] *Ante*, § 2847.

tions under which its members, resident or non-resident, shall hold their shares in respect of the exercise of the State's taxing power. Moreover, we have seen that the corporation is, in theory of law, in a sense the trustee of the legal title of its shareholders, and the custodian of the rights represented by their share certificates.[1] In this sense, the shares may well be regarded as having a *situs* at the *situs* of the corporation; so that by exerting its taxing power against the corporation, the State can coerce the payment of taxes which fall ultimately upon the shareholder, whether they belong to residents or non-residents of the State, as is done every day, and this without violating any legal theory.[2] So, under the national banking act, it is competent for the legislature of a State to prescribe that the shares of *resident stockholders* in national banking associations shall be taxable at the place where the bank is located, and not elsewhere.[3]

§ 2850. Even in the Case of National Bank Shares Held by Residents.— Soon after the passage of the National Banking Act, a controversy arose as to the meaning of the clause which permitted shares in such banks to be taxed by the State " at the place where the bank is located, and not elsewhere." In some of the States it was held that the legislature was confined in the exercise of the taxing power to the towns or districts in which the corporation conducted its business, while in others it was decided to apply to the State, and not to any of its territorial divisions, and that such a tax could be assessed upon a resident stockholder at the place of his residence wherever it might be, within the State.[4] The controversy was solved by Congress in

[1] *Ante*, § 2486.

[2] For example, the Maryland Act of 1874, ch. 483, § 87; Baltimore *v.* Baltimore &c. R. Co., 57 Md. 31, 35; reaffirmed American Coal Co. *v.* County Com'rs, 59 Md. 185, 192. The *reasons* which uphold this power are ably set forth by Waite, C. J., in Tappan *v.* Merchants' Nat. Bank, 19 Wall. (U. S.) 490, 499; by Alvey, J., in American Coal Co. *v.* County Com'rs, 59 Md. 185, 193; by Taft, J., in St. Albans *v.* National Car Co., 57 Vt. 68, 80, 82; and by Lurton, J., in Street Railroad Co. *v.* Morrow, 87 Tenn. 406; *s. c.* 2 L. R. A. 853, 860; 5 Rail. & Corp. L. J. 248; 11 S. W. Rep. 348.

[3] Tappan *v.* Merchants' Nat. Bank, 19 Wall. (U. S.) 490.

[4] Burr. Tax, 127, 128; Austin *v.* Boston, 14 Allen (Mass.), 359; *s. c.* Aff'd, 7 Wall. (U. S.) 694; 1 Nat. Bk. Cas. 15; Clapp *v.* Burlington, 42 Vt. 579; *s. c.* 1 Am. Rep. 355;

1868 by passing an amendatory act, declaring that the word "*place*" in the statute should be taken to mean the "*State*" wherein the bank was located. This, it has been held, left but two restraints upon a State in the exercise of its taxing power over shares in national banks: 1. That such shares shall not be taxed at a greater rate than is assessed upon other moneyed capital in the hands of its individual citizens. 2. That the tax on shares *of non-residents* shall be imposed in the city or town where the bank is located. In respect of *resident* shareholders, it left the State free to assess their shares for taxation either at the place of their actual residence or at the place where the bank was located, as the legislature might elect.[1] The act of Congress confined itself to the policy of prohibiting the taxation of such shares by States other than those in which the bank was situated, and it remained, under the amendment as before, that the act of Congress prescribed an arbitrary or artificial *situs* for the shares of non-resident holders, which *situs* was the *situs* of the bank; so that such shares could only be taxed by the State, or by its subdivisions or municipalities, within the city or town where the bank was located.[2] Recognizing this rule, it has been held by the Supreme Judicial Court of Massachusetts, construing the statutes of that State, that shares in a national bank, of stockholders who reside in a regularly organized *fire district* in the town in which the bank is located, cannot be subjected to a tax assessed for fire district purposes.[3] The reason is found in a statute which enacts that "all the shares of stock in banks, whether of issue or not, existing by authority of the United States or of the commonwealth, and located within

Smith, C. J., in Buie *v.* Fayetteville, 79 N. C. 267; *s. c.* 2 Nat. Bk. Cas. 343.

[1] Buie *v.* Fayetteville, 79 N. C. 267, 270; First Nat. Bank *v.* Smith, 65 Ill. 44, 48.

[2] Kyle *v.* Fayetteville, 75 N. C. 445, 449. This is the explicit language of the statute, which says that "the legislature in each State may determine and direct the manner and place of taxing all the shares of national banking associations located within the State, subject only to two restrictions, that the taxation shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State, and that the shares of any national banking association owned by non-residents of any State shall be taxed in the city or town where the bank is located, and not elsewhere." Rev. Stat. U. S., § 5219.

[3] Rich *v.* Packard National Bank, 138 Mass. 527.

the commonwealth, shall be assessed to the owners thereof in the cities or towns where such banks are located, and not elsewhere, in the assessment of all State, county, and town taxes imposed and levied in such place, whether such owner is a resident of said city or town, or not,'' etc.[1] It is perceived that this statute confers no authority to lay a tax upon such shares for fire district purposes. The conclusion of the court, therefore, was that an assessment of a tax for such a purpose, even upon a shareholder residing in the town where the bank was located, was illegal.[2]

§ **2851. Subject to Qualifications.**— What is here said must be taken subject to any restraints imposed upon the legislature of the State in respect of the exercise of the power of taxation, by the constitution of the United States or by the constitution of the State. It should also be noted that there are decisions of respectable courts denying the power of the legislature of a State to lay a tax upon the shares of domestic corporations held by non-residents. There is, for instance, a holding in Massachusetts to the effect that, the *situs* of shares for the purposes of taxation being the residence of the shareholder, the State has no power to tax the shares of non-resident shareholders in domestic corporations, by the device of requiring the corporation to reserve a certain portion of all *dividends* on its shares owned by non-residents, and to pay the same into the State treasury.[3] So, the Supreme Court of Tennessee, in an early case which has been much cited and commented on, held that it is beyond the power of the legislature of a State to impose a tax upon the shares of a corporation of the State, which are held by non-residents.[4] The conclusion of the court was based upon the premise that corporate shares, being intangible, can have no actual *situs*, and " must therefore *of necessity* follow the person

[1] Public Stats. Mass., ch. 13, § 8.

[2] The court add that "the rules which formerly prevailed when bank shares, like other personal property, were taxable to the owner in the place of his domicile, and were thus taxable to him, if a resident in a fire or school district, for the purposes thereof, do not apply in the present system." Dwight *v.* Springfield &c. Fire District, 11 Met. (Mass.) 374; Little *v.* Little, 131 Mass. 367.

[3] Oliver *v.* Washington Mills, 11 Allen (Mass.), 268.

[4] Union Bank *v.* State, 9 Yerg. (Tenn.) 490.

of the owner.[1]" But this premise is quite unsound. It is not *necessary* that the *situs* of intangible property, for the purposes of taxation, should follow the person of the owner. The doctrine is rather allied to the common law *fiction* that the *situs* of all personal property follows the residence of the owner; and to say that the legislature which created the corporation cannot abolish that fiction in respect of it is tantamount to saying that the legislature cannot change the common law. The Massachusetts case, above referred to,[2] is equally unsound in so far as it proceeds upon the same premise. But it should be noted that the Massachusetts court seek support for their conclusion in the proposition that a tax laid upon the shares of non-residents, while no tax is laid upon the shares of residents, would be a violation of that clause of the constitution of the United States which secures to the citizens of one State the *privileges and immunities* of the citizens of the several States.[3]

ARTICLE V. TAXATION OF SHARES IN NATIONAL BANKS.

[1] *Ibid.*, p. 500.

[2] Oliver *v.* Washington Mills, 11 Allen (Mass.), 268.

[3] There is a holding by a Federal district judge, relating to the power of a city to tax its own obligations held by non-residents, in which, independently of a statute expressly exempting such obligations from taxation, the learned judge intimates that, "as a rule of law, where there is no pre-existing legislation, they have no *situs* except that which is imparted by the residence of the owner; and to attempt to tax outside of that residence is to add to the qualities of personal property that of having an artificial and forced location, contrary to the settled rules which govern that class of property." De Vignier *v.* New Orleans, 16 Fed. Rep. 11, 12.

§ 2854. States and Municipalities have no Power to Tax National Banks.— Congress has the constitutional right to authorize the incorporation of *banks*. A bank thus incorporated has a right to establish its offices of discount and deposit within any State, if empowered to do so by its charter, and when so established it does not subject itself to the power of taxation of the State.[1]

§ 2855. Right of the States to Tax National Bank Shares Derived Wholly from Act of Congress.— The Supreme Court of the United States having determined that the national bank established by act of Congress is to be regarded as one of the constitutional means employed by Congress in carrying out its powers, and that it is not within the power of the States, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of a constitutional law enacted

[1] It was accordingly held that the State of Maryland could not impose a tax on the bank of the United States incorporated under the act of Congress of April 10, 1816. McCulloch *v.* Maryland, 4 Wheat. (U. S.) 316. The principle therein announced has been reaffirmed and applied to the act of Congress authorizing the incorporation of national banks in many cases. Van Allen *v.* Assessors, 3 Wall. (U. S.) 573; *s. c.* 1 Nat. Bk. Cas. 1; Bradley *v.* People, 4 Wall. (U. S.) 459; *s. c.* 1 Nat. Bk. Cas. 14; Lionberger *v.* Rouse, 9 Wall. (U. S.) 468; *s. c.* 1 Nat. Bk. Cas. 41; Hepburn *v.* School Directors, 23 Wall. (U. S.) 480; *s. c.* 1 Nat. Bk. Cas. 113; Stetson *v.* Bangor, 56 Me. 274; *s. c.* 1 Nat. Bk. Cas. 520.

by Congress to carry into effect the powers vested in the national government, and hence, that it is not competent for Congress to impose a tax on national banks,[1]— it must follow that the right of the State to tax the property, capital, or shares, of a national bank, can exist only under a power granted by Congress, and that it must find its limitations in the terms of the grant. Such a power has been granted by Congress in a provision of the National Banking Act, quoted in the next section.

§ 2856. Text of the Federal Statute Permitting Such Taxation.— It is provided by the act of Congress known as the National Banking Act, as follows: "Nothing herein shall prevent all the shares in any association from being included in the valuation of the personal property of the owner or holder of

[1] McCulloch *v.* State, 4 Wheat. (U. S.) 316; Osborn *v.* Bank of U. S., 9 Wheat. (U. S.) 738. On the same theory it is held that a tax imposed by or under a State law, on stocks issued for loans made to the United States, is unconstitutional and void. Weston *v.* Charleston, 2 Pet. (U. S.) 449. It has been furthermore held that a State law taxing the *loans* of the United States is unconstitutional where it imposes a tax upon the stocks or bonds of the United States issued for such loans, *eo nomine*, or includes it in the aggregate of the tax-payer's property, to be appraised, like the rest, on its value. The imposition of such a tax is a restriction upon the constitutional power of the United States to borrow money, and the power so to tax might be used, if conceded to exist, so as to defeat the Federal power altogether. People *v.* Commissioners, 2 Black (U. S.), 620. On the same theory, it is held that a State tax on banks, "on a valuation equal to the amount of their *capital stock* paid in, or secured to be paid in," is a tax on the *property* of the bank, and, in so far as such property is invested in securities of the United States, the tax is void. Bank Tax Case, 2 Wall. (U. S.) 200. On the same theory, the capital stock of a national bank, which is invested in government securities, is not liable to State taxation; but, as elsewhere seen (*post*, §§ 2856, 2863, *etseq.*), the shares of the stockholders are taxable at the same rate as other moneyed capital in the hands of citizens of the particular State, without regard to the mode of investment, and although the entire capital of the bank may be invested in non-taxable government securities. National Bank *v.* Commonwealth, 9 Wall. (U. S.) 353. On the like theory, United States *legal tender notes*, issued to circulate as currency, are exempt from taxation, and a bank holding such notes is entitled to a deduction from its assessment in respect of them. Bank *v.* Supervisors, 7 Wall. (U. S.) 26. And so are the *certificates of indebtedness*, issued by the United States to its creditors for supplies furnished to it in carrying on the War of the Rebellion. Banks *v.* Mayor, 7 Wall. (U. S.) 16.

such shares, in assessing taxes imposed by authority of the State within which the association is located; but the legislature of each State may determine and direct the manner and place of taxing all the shares of national banking associations located within the State, subject only to the two restrictions, that the taxation shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State, and that the shares of any national banking association owned by non-residents of any State shall be taxed in the city or town where the bank is located, and not elsewhere. Nothing herein shall be construed to exempt the real property of associations from either State, county, or municipal taxes, to the same extent, according to its value, as other real property is taxed."[1] This statute furnishes the text for nearly all that follows in this article.

§ **2857. Capital not Taxable in Solido.** — This section invests the States with the power to tax the *shares* of individual shareholders in like manner as other moneyed capital is taxed, but not to lay a tax upon the *capital* of the banking corporation *in solido*.[2]

[1] Act. Cong. June 3, 1864, § 41; 13 U. S. Stat. at Large, 99; Rev. Stats. U. S., § 5219.

[2] First Nat. Bank *v.* Richmond, 39 Fed. Rep. 309; National Bank *v.* Richmond, 42 Fed. Rep. 877; Hills *v.* Exchange Bank, 105 U. S. 319; Whitbeck *v.* Mercantile Nat. Bank, 127 U. S. 193; *s. c.* 3 Nat. Bk. Cas. 309; Van Allen *v.* Assessors, 3 Wall. (U. S.) 573; *s. c.* 1. Nat. Bk. Cas. 1; People *v.* Commissioners, 4 Wall. (U. S.) 244; *s. c.* 1 Nat. Bk. Cas. 9; National Bank *v.* Commonwealth, 9 Wall. (U. S.) 353; *s. c.* 1 Nat. Bk. Cas. 34; Mercantile Bank *v.* New York, 121 U. S. 138; Lionberger *v.* Rouse, 9 Wall. (U. S.) 468, 475; *s. c.* 1 Nat. Bk. Cas. 41; affg. *s. c.* 43 Mo. 67; Waite *v.* Dowley, 94 U. S. 527, 533; *s. c.* 1 Nat. Bk. Cas. 137; Supervisors *v.* Stanley, 105 U. S. 305; *s. c.* 3 Nat. Bk. Cas. 33; National Bank *v.* Kimball, 103 U. S. 732; *s. c.* 3 Nat. Bk. Cas. 9; Pelton *v.* National Bank, 101 U. S. 143; *s. c.* 2 Nat. Bk. Cas. 85; Cummings *v.* National Bank, *Id.* 153; *s. c.* 2 Nat. Bk. Cas. 74; Davenport Bank *v.* Davenport Board of Equalization, 123 U. S. 83; *s. c.* 8 Nat. Bk. Cas. 285; People *v.* Weaver, 100 U. S. 539; *s. c.* 2 Nat. Bk. Cas. 57; National Commercial Bank *v.* Mobile, 62 Ala. 284; *s. c.* 34 Am. Rep. 15; 2 Nat. Bk. Cas. 440; Sumter County *v.* National Bank, 62 Ala. 464; *s. c.* 34 Am. Rep. 30; 2 Nat. Bk. Cas. 449; Adams *v.* Nashville, 95 U. S. 19; *s. c.* 1 Nat. Bk. Cas. 148; Springfield *v.* First Nat. Bank, 87 Mo. 441; *s. c.* 3 Nat. Bk. Cas. 524. See also Bradley *v.* People, 4 Wall. (U. S.) 459; Nat. Bank *v.* Meredith, 44 Mo. 500; State *v.* Dowling, 50 Mo. 314.

§ 2858. Personal Property of Such Banks not Taxable.— The personal property of national banks, such as their safes, office furniture, etc., is not taxable by the State.[1]

§ 2859. Taxing their Circulating Notes in the Hands of their Owners.—It has been held,[2] and denied [3] that their circulating notes are taxable by the States in the hands of their owners, as other money, except treasury notes, would be, — the question turning on the inquiry whether they are *obligations of the United States* within the meaning of certain statutes of the United States creating exemptions from State taxation. There should be no doubt whatever that they are so taxable.

§ 2860. Taxing their Surplus, Profits, etc.— Their surplus and profits and reserve fund may be considered in ascertaining the actual cash value of the shares,[4] and if not so included, may be separately taxed as surplus, if not invested in Federal securities.[5]

§ 2861. Taxing a State Bank Reorganizing as a National Bank.— While a State bank is in process of change to a national bank it is subject to State taxation.[6]

§ 2862. State Taxation after Insolvency. — The personal property of an insolvent national bank, in the hands of a *receiver* appointed under the statute,[7] is exempt from taxation under State laws. Such property in legal contemplation still belongs to the

[1] National State Bank *v.* Young, 25 Iowa, 311; *s. c.* 1 Nat. Bk. Cas. 451. The court say: "The express grant of this power to tax specific property is conclusive evidence of the intention to withhold the power to tax other property." See Covington City Nat. Bk. *v.* Covington, 21 Fed. Rep. 484.

[2] Commissioners *v.* Elston, 32 Ind. 27; 2 Am. Rep. 327; *s. c.* 1 Nat. Bk. Cas. 425.

[3] Horne *v.* Green, 52 Miss. 452; *s. c.* 1 Nat. Bk. Cas. 643. The circulating notes of *State banks* are taxable by the United States. Veazie Bank *v.* Fenno, 8 Wall. (U. S.) 533; *s. c.* 1 Nat. Bk. Cas. 22.

[4] St. Louis Nat. Bank *v.* Papin, 1 Nat. Bk. Cas. 326; First Nat. Bk. *v.* Peterborough, 56 N. H. 38; *s. c.* 1 Nat. Bk. Cas. 658; Strafford Nat. Bk. *v.* Dover, 58 N. H. 316; *s. c.* 2 Nat. Bk. Cas. 296.

[5] State *v.* Newark, 39 N. J. L. 380; *s. c.* 1 Nat. Bk. Cas. 672.

[6] Com. Manf. &c. Bank, 2 Pearson's Decisions, 386; *s. c.* 2 Nat. Bk. Cas. 459.

[7] Rev. Stat. U. S., § 5234.

bank, though in the hands of a receiver, to be administered under the law. The bank does not cease to exist on the appointment of a receiver. Its corporate capacity continues until its affairs are finally wound up and its assets distributed. If the shares have any value, they are taxable in the hands of the holders or owners under this section; but the property held by the receiver is exempt to the same extent it was before his appointment.[1] A tax levied on the property of the bank subsequent to its insolvency is subordinate to the rights of a receiver appointed after the levy.[2]

§ **2863. Shares and not Capital Taxable.**—The foregoing statute[3] confers upon the States the power to tax the shares of the *several shareholders* in a national bank located within the State, subject to the two restrictions named, and clothes the legislature of the State with the power to determine and direct the manner and place of taxing the shares. The State legislatures cannot evade the rule which exempts the capital stock of national banks from taxation, by enacting statutes taxing the shares of such banks *in the aggregate* and requiring the bank or its cashier to pay such tax.[4] The shares must be taxed separately, so that the owner may have his indebtedness deducted and have equalization.[5] But to claim *exemption* from taxation on its property, it must be made to appear that it is in the precise form of capital.[6]

§ **2864. What is a Tax on Capital, and What on Shares.**—A tax "on bank stock, of fifty cents on each share thereof equal

[1] Rosenblatt *v.* Johnson, 104 U. S. 462.

[2] Woodward *v.* Ellsworth, 4 Col. 580; *s. c.* 2 Nat. Bk. Cas. 216.

[3] *Ante,* § 2856.

[4] National &c. Bank *v.* Mobile, 62 Ala. 284; *s. c.* 34 Am. Rep. 15; 2 Nat. Bk. Cas. 440; Sumter County *v.* National Bank, 62 Ala. 464; *s. c.* 34 Am. Rep. 30; 2 Nat. Bk. Cas. 449; Miller *v.* First Nat. Bank, 46 Ohio St. 424; *s. c.* 3 Nat. Bk. Cas. 711.

[5] First Nat. Bank *v.* Richmond, 39 Fed. Rep. 309.

[6] Canal &c. Banking Co. *v.* New Orleans, 99 U. S. 97; *s. c.* 2 Nat. Bk. Cas. 22. A statute providing that shares in banks shall be assessed to the shareholders, but requiring the bank to pay taxes so assessed, and authorizing it to collect the same from the shareholders, imposes a tax, not upon banks, but upon its shares. Whitney Nat. Bk. *v.* Parker, 41 Fed. Rep. 402.

to one hundred dollars of stock therein, owned by individuals, corporations, or societies," is a tax on the shares.[1]

§ 2865. **Municipal Taxation of Such Shares.** — Municipal officers cannot assess national bank shares unless authorized by State law, but it may be done under a statute authorizing "taxation of all shares in moneyed corporations."[2] National banks are not liable to pay a *license fee* imposed by a city ordinance, although "banks and banking" are included in terms.[3] Where, by a State statute, a national bank is not taxable for "municipal purposes," it may nevertheless be taxed for school purposes or to aid in building a railroad under township donation, as these are not "municipal purposes."[4] Where the State law made national bank shares taxable in the township where the bank was located, except that where a shareholder resided in another township in the same county his shares were to be taxed there, under a village charter authorizing the taxation of all property within the limits of the village, shares of stock of such bank located in such village, but owned by a resident of another township, are not taxable by the village.[5]

§ 2866. **Place of Assessment and Taxation.** — Referring to a controversy which sprung up under the original act and its solution by an amendatory act of Congress,[6] it was held, under the original act, that a State statute that the shareholders should be taxed in the county, town, or district where the bank was located, whether they resided there or not, was valid.[7] Dealing with the act as thus amended, it is said that the only

[1] National Bank *v.* Commonwealth, 9 Wall. (U. S.) 343; *s. c.* 1 Nat. Bk. Cas. 34.

[2] Stetson *v.* Bangor, 56 Me. 274; *s. c.* 1 Nat. Bk. Cas. 520.

[3] National Bank of Chattanooga *v.* Mayor, 8 Heisk. (Tenn.) 814; *s. c.* 1 Nat. Bk. Cas. 903; Carthage *v.* First Nat. Bank, 71 Mo. 508; *s. c.* 36 Am. Rep. 494; *s. c.* 2 Nat. Bk. Cas. 279; Macon *v.* First Nat. Bank, 59 Ga. 648; *s. c.* 2 Nat. Bk. Cas. 219; Second National Bank *v.* Caldwell, 13 Fed. Rep. 429.

[4] Root *v.* Erdelmeyer, 37 Ind. 225, 227; *s. c.* 1 Nat. Bk. Cas. 432.

[5] Howell *v.* Cassapolis, 35 Mich. 471; *s. c.* 1 Nat. Bk. Cas. 627.

[6] *Ante*, § 2850.

[7] Tappan *v.* Merchants' Nat. Bank, 19 Wall. 490; *s. c.* 1 Nat. Bk. Cas. 100; overruling Union Nat. Bank *v.* Chicago, 3 Biss. 82; Whitney *v.* Ragsdale, 33 Ind. 107; *s. c.* 5 Am. Rep. 185; *s. c.* 1 Nat. Bk. Cas. 429; First Nat. Bank *v.* Smith, 65 Ill. 44; *s. c.* 1 Nat. Bk. Cas. 390.

restraints imposed upon a State in the exercise of its taxing power over the shares of national banks are therefore said to be: 1. That such tax shall not be at a greater rate than is assessed upon other moneyed capital in the hands of its individual citizens. 2. That the tax on shares of *non-residents* shall be imposed in the city or town where the bank is located. Subject to these limitations, it is left to the legislature of a State to "determine and direct the manner and place of taxing all the shares."[1] Moreover, it is held that the shares of national bank stock *owned by residents* of the State may be assessed, under the act of Congress, either at the place where such owners reside, or at the place where the bank is located, as the legislature of the State may elect.[2] The State may not tax a resident on stock owned by him in a national bank of another State.[3] An assessment against a national bank on the stock of the bank, owned by a shareholder residing in the city where the bank is located, cannot be sustained by the *presumption* that he resided in the ward in which he was located, but must be against the shareholder, for that is his right under the law of New Jersey.[4] A national bank located in New Jersey is not rendered taxable in Philadelphia because it keeps a clerk there to receive deposits.[5]

§ 2867. What is Meant by "Moneyed Capital." — A recent authoritative definition of this phrase has been given by the

[1] Smith, C. J., in Buie *v.* Fayetteville, 79 N. C. 267; *s. c.* 2 Nat. Bk. Cas. 343. That the shares of stock held by non-residents in a national bank can only be taxed in the city or town wherein the bank is located; was ruled in Kyle *v.* Fayetteville, 75 N. C. 445; *s. c.* 1 Nat. Bk. Cas. 808, decided in 1876.

[2] Buie *v.* Fayetteville, 79 N. C. 267; *s. c.* 2 Nat. Bk. Cas. 343. Under laws existing in North Carolina in 1877, such shares could only be taxed at the place where the owner or person who was required to list them resided. *Ibid.* Therefore, where the owner of such stock resided just outside the corporate limits of the city within which the bank was located, he might be taxed in respect of such shares for municipal purposes, under a statute of North Carolina amendatory of the charter of the city, providing that all persons whose ordinary vocations are pursued within the corporate limits of the town, although resident beyond the limits, should be taxed for municipal purposes in like manner and to the same extent as persons resident within the corporate limits. Moore *v.* Fayetteville, 80 N. C. 154; *s. c.* 30 Am. Rep. 75; 2 Nat. Bk. Cas. 350.

[3] Fluit *v.* Boston, 99 Mass. 141; 96 Am. Dec. 713; *s. c.* 1 Nat. Bk. Cas. 571.

[4] State *v.* Newark, 40 N. J. L. 558; *s. c.* 2 Nat. Bk. Cas. 290; rev'g 39 N. J. L. 380; *s. c.* 1 Nat. Bk. Cas. 672.

[5] National State Bank *v.* Pierce, 2 Nat. Bk. Cas. 177.

Federal Supreme Court,[1] which holds that a New York statute which provides that the stockholders in banks and trust companies organized under the authority of the State, or of the United States, shall be assessed for the value of their shares of stock, but which omits to provide for the taxation of shares of stock in other private corporations, does not contravene the Federal statute already quoted,[2] which forbids the taxation of shares in national banks at a greater rate than is assessed on other "moneyed capital" in the hands of the individual citizens of the State, the purpose of the Federal statute being to prevent unjust discrimination against United States banks, and the term "moneyed capital" meaning *capital* employed to make a profit from the use of it *as money,— e. g.*, in the business of banking. It has been said that, although a railroad company, a mining company, an insurance company, or any other corporation of that description, may have a large part of its capital invested in securities, payable in money, and so may be the owner of "moneyed capital," yet the *shares of stock* in such companies held by individuals are not "moneyed capital," because the operations in which such money, so invested in such companies, is employed, is not the business of lending money for hire, or of discounting bills of exchange, or of receiving deposits payable on demand, etc.[3] It is also said that "moneyed capital" within the meaning of the statute under consideration, is money employed in such a manner that national banks are drawn into competition with the corporation or person employing it.[4] The phrase "other moneyed capital," used in the statute,[5] means, of course, other *taxable* moneyed capital; so that the *valuation* of shares in national banks, for the purpose of taxation, is not, within the meaning of the statute, at a greater rate than the valuation of other moneyed capital, unless such other moneyed capital is subject to taxation.[6]

1 Palmer *v.* McMahon, 133 U. S. 660; 10 Sup. Ct. Rep. 324; aff'g 102 N. Y. 176; *s. c.* 55 Am. Rep. 796; 2 Nat. Bk. Cas. 636.

2 Rev. St. U. S., § 5219; *ante*, § 2855.

3 Mercantile Bank *v.* New York, 121 U. S. 138.

4 Mercantile Nat. Bank *v.* Shields, 59 Fed. Rep. 952, per Rick, J.

5 Rev. St. U. S., § 5219; *ante*, § 2855.

6 Exchange Nat. Bank *v.* Miller, 19 Fed. Rep. 372.

§ 2868. What Constitutes Unlawful Discrimination in Such Taxation.— By the section of the National Banking Act already set out,[1] permission has been given to the States to tax the shares in national banking associations, "but not at a greater *rate* than is assessed upon other moneyed capital in the hands of individual citizens of such State." The meaning of this is held to be that "no greater proportion or percentage of tax, in the *valuation* of the shares, should be levied than upon other moneyed taxable capital in the hands of citizens."[2] Under this section and within the limitations therein prescribed, the whole interest of a shareholder in the shares held by him in a national bank are left subject to State taxation, which the State has a sovereign right and concurrent power with Congress to impose (but from the exercise which Congress, by reason of its paramount authority, may exclude the State), although the capital of such bank may be wholly invested in securities of the United States.[3] The intention of Congress in the first of those limitations was that the rate of taxation on the shares should be the same, or not greater, than upon the moneyed capital of the individual citizen which is subject or liable to taxation. That is, no greater proportion or percentage of tax in the valuation of the shares should be levied, than upon other moneyed capital in the hands of the citizens.[4] The test by which to prevent discrimination against the shares is confined to the rate of assessments upon moneyed capital in the hands of individual citizens, so that the fact of insurance companies created under the laws of the State, and doing business in the city of New York, being respectively assessed upon the balance of their capital and surplus profits, liable to taxation, after deducting therefrom such part as is invested in United States securities, has no bearing on the question of the taxation of shares. These institutions are not within the words or the contemplation of Congress; they are taxed on their capital, and not on the shareholder, at the same rate as other personal property in the State.[5] It must be shown

[1] *Ante*, § 2856.

[2] People *v.* Commissioners, 4 Wall. (U. S.) 244, 256.

[3] Van Allen *v.* Assessors, 3 Wall. (U. S.) 573.

[4] *Ibid.*

[5] People *v.* Commissioners, 4 Wall. (U. S.) 244.

that there is in fact a higher burden of taxation imposed upon money thus invested than upon other moneyed capital. To show merely that the State laws provide a different mode or manner of taxing moneyed capital invested in savings banks or other corporations, is not enough. Accordingly, statutes of Iowa, providing for the taxation of the shares of national banks, and providing for the organization of *savings banks*, and enacting that the shares of stock therein are taxable, but that deposits are not, do not discriminate against national banks or the capital therein invested.[1] Under the statute, where the State banks are taxed on *capital* only, a tax on national bank *shares* is void.[2] It has been held that where the taxing law of a State, as construed by the highest judicial authority of the State,[3] allows a *deduction*, of legal and *bona fide debts* owing by citizens of the State, to be made from *credits* held by them for the purposes of taxation, but does not allow such a deduction from the shares of national banks, this is a discrimination in favor of "other moneyed capital of the State" against national banks, within the prohibition of the Federal statute under consideration, and that it is none the less so from the fact that no such deduction is allowed in the case of the shares of railroad insurance, or manufacturing corporations, such shares not being "moneyed capital."[4] It is held in the same case that, under the clause of the statute providing "that shares of any national banking associations owned by *non-residents* of any State may be taxed where the bank is located,"[5] a *non-resident* shareholder, who is compelled to pay the tax at such place, is entitled to all *deductions* from the value of his shares, on account of debts, that are allowed to *resident* shareholders.[6]

§ 2869. Unlawful Discrimination as between National Banks and State Moneyed Institutions Other than Banks. — In the construction of this grant of the power of taxation, it has

[1] Richards *v.* Rock Rapids, 31 Fed. Rep. 505.

[2] Van Allen *v.* Assessors, 3 Wall. (U. S.) 573; Bradley *v.* People, 4 Wall. (U. S.) 459.

[3] Here, as construed in Niles *v.* Shaw, 50 Oh. St. 370; *s. c.* 34 N. E. Rep. 162.

[4] Mercantile Nat. Bank *v.* Shields, 59 Fed. Rep. 952.

[5] Rev. Stats. U. S., § 5219; *ante*, § 2856.

[6] Mercantile Nat. Bank *v.* Shields, 59 Fed. Rep. 952.

become established by the Supreme Court of the United States that it is not enough, to support the validity of a tax imposed by a State upon shares in national banks, that such tax is imposed *at the same rate and upon the same valuation upon which taxes are imposed by the State upon shares in banking institutions incorporated by the legislature of the State.* In other words, it is not sufficient that the State law establishes equality, in respect of the taxation of bank shares, between the national banks and the State banks; but the equality must extend further, and the rate of taxation and of valuation must be the same as that established by the State upon *other investments of moneyed capital* by its citizens. If, therefore, the revenue law of the State allows the tax-payer a *deduction* from an assessment against his ordinary personal property, including his moneyed investments, other than his investments in bank shares, to the extent of his indebtedness, or of his indebtedness to the State, and the same law allows no such deduction where the personal property which is the subject of the assessment consists of bank shares, whether of national or of State banks, — the scheme of taxation will be invalid, in so far as it applies to national banks; because it results that the shareholder in a national bank is taxed at a greater rate than the holder of ordinary corporate bonds, or of notes secured by mortgages, or the owner of any other species of moneyed investment.[1]

§ 2870. Unlawful Discrimination in Making the Assessments. — It has been held that a taxation of national bank shares is not invalid because in the case of a single State bank, the shares of which are subject to a like taxation, the assessors, either by mistake or intention, have shown favor; since any scheme of taxation must produce some inequality in its workings, and such as this is remediable, if at all, by the State authorities.[2] Another Federal court has held that discrimination in the *valuation* for

[1] People *v.* Weaver, 100 U. S. 539; reversing an unreported decision of the Court of Appeals of New York, and overruling the prior decision of that court in People *v.* Dolan, 36 N. Y. 59; followed by the Supreme Court of California in Miller *v.* Heilbron, 58 Cal. 133.

[2] Supervisors *v.* Stanley, 105 U. S. 305, 317; *s. c.* on second hearing, 15 Fed. Rep. 483.

taxation of shares in national banks and other property must be *intentional* to be illegal, and this may be established by proof of inequalities so gross as to show design.[1] When, therefore, the taxing officials, by a tacit understanding, assess all personal property at six-tenths of its actual value, but the national banks are assessed at a larger per centum of the actual value of their shares, the collection of the excess will be restrained, although the excess is imposed by the State board of equalization, in its attempts to equalize the national banks among themselves throughout the State, or to equalize all "incorporated banks," State and national. Such equalization must be as to all "moneyed capital in the hands of individual citizens of the State." Hence, if the State board of equalization for the "incorporated banks" of the State attempt to equalize the national banks in one class and the State banks in another, but adopt one standard of percentages for the State banks and another for the national banks, upon the same basis of principal sums for calculation as to each class, and maintain the average of one class at a different figure from the average of the other, and the result is an assessment of the national banks at a higher valuation comparatively than the others, this is evidence of an unlawful discrimination; and if they assess the plaintiffs' shares at a valuation higher than other moneyed capital in the county or city where they are located, the excessive taxation will be restrained.[2] From the doctrine that a statutory rule fixing the taxable value of shares, which does not permit a *deduction* of the amount of United States bonds or other non-taxable securities held by the bank, is not invalid,[3] the conclusion has been drawn that the elimination from the returns made by unincorporated banks and individual bankers to the assessing officers in Ohio, of their United States bonds and other non-taxable securities, is not a deduction nor a discrimination against the holder and owner of shares in national banks, although such shares are valued for taxation without such deduction for the non-taxable securities held and owned by the bank.[4] There are early and seemingly untenable holdings to the effect that the

[1] Exchange Nat. Bank *v.* Miller, 19 Fed. Rep. 372.

[2] First Nat. Bank *v.* Treasurer, 25 Fed. Rep. 749.

[3] *Ante*, §. 2840.

[4] Exchange Nat. Bank *v.* Miller, 19 Fed. Rep. 372.

imposition of a higher assessment and heavier tax upon the shares of a national bank than those imposed upon the capital stock and personal property of other corporations within the State does not contravene the statute under consideration.[1] But the failure of the assessors to place the names of the shareholders upon the assessment-roll, in accordance with the requirement of the State statute, renders such tax void, although they keep a separable list containing the same information with the knowledge of the shareholders.[2] Notwithstanding these earlier holdings, the authoritative doctrine is that where, notwithstanding the statute requires all moneyed capital to be appraised for the purpose of taxation at its true cash value, the assessors systematically appraise all other moneyed capital at much less than its true value, while national bank shares are assessed at their full value, the tax on shares thus assessed is invalid; and that upon payment into court of the amount due upon a valuation determined according to the rule by which other moneyed capital is valued, a court of equity will restrain the collection of the balance.[3]

§ **2871. Assessing Shares at Their Actual Value.**— Statutory systems exist, in which, for the purpose of determining the amount of taxation to be paid by a corporation upon its capital stock, an assessment is made of its aggregate share capital at its *actual* or *market*, and not at its *normal*, value. Such was the system in New York applicable to manufacturing corporations in the year 1860.[4] In the same State, shares of stock in national banks were assessed for taxation at their actual value, and this

[1] Rev. Stats. U. S., § 5219; *ante*, § 2856.

[2] Albany City Nat. Bank *v.* Maher, 6 Fed. Rep. 417; First Nat. Bank *v.* Waters, 7 Fed. Rep. 152; 19 Blatch. 242. But the mere omission of a clerk to extend upon the assessment-roll the amount to be paid by each shareholder until after delivery of the roll to the city treasurer, does not render the tax void. First Nat. Bank *v.* Waters, 7 Fed. Rep. 152; 19 Blatch. 242.

[3] Pelton *v.* National Bank, 101 U. S. 143. See Puget Sound Nat. Bank *v.* King County, 57 Fed. Rep. 433. A tax was levied on money in January, with which the owner bought national bank shares in March. It was held that the shares could be assessed under a statute providing that persons should be assessed for bank stock owned by them on April 1st. Richmond *v.* Scott, 48 Ind. 568; *s. c.* 1 Nat. Bk. Cas. 445.

[4] Under the New York Act of 1857, chapter 456; Oswego Starch Factory *v.* Dolloway, 21 N. Y. 449.

system of taxation was upheld as not in contravention of any Federal statute;[1] although in the last-named case the amount assessed as the actual value of the shares was subject to *deduction*, in respect of the proportion of the shareholder of the value of the real estate of the incorporated bank. From the foregoing it may well be concluded that national bank shares must be taxed at their market value, although *above par*.[2] Where it appears that there is an inequality in the actual or market value of the shares of different banking corporations,— as will appear from the facts of a case involving this question, where the plaintiff's shares were assessed at their par value of $100 per share, though they were worth $130 per share, while the shares in another bank were assessed at the same rate, while they were worth $300 per share,— it must be concluded that such an assessment is not made *on the value* of the shares, as required by the governing statute.[3]

§ **2872. Deductions for Debts.**—The shareholder in a national bank is entitled, in the valuation of his shares for State or municipal taxation, to be allowed the same *deduction* for debts which is allowed under the State law in fixing the valuation of "other moneyed capital in the hands of citizens of the State." [4]

[1] People *v.* Commissioners, 94 U. S. 415; People *v.* Commissioners, 67 N. Y. 516.

[2] Hepburn *v.* School Directors, *supra;* People *v.* Commissioners, *supra;* People *v.* Assessors of Albany, 5 Thomp. & C. (N. Y.) 155; *s. c.* 1 Nat. Bk. Cas. 776; Exch. Nat. Bank *v.* Miller, 19 Fed. Rep. 372.

[3] Williams *v.* Weaver, 75 N. Y. 30; *s. c.* aff'd, on another point, 100 U. S. 547.

[4] City Nat. Bank *v.* Paducah, 2 Flip. (U. S.) 61; *s. c.* 1 Nat. Bk. Cas. 300; People *v.* Weaver, 100 U. S. 539; *s. c.* 2 Nat. Bk. Cas. 57; National Exch. Bank *v.* Hills, 2 Nat. Bk. Cas.*456; Evansville Bank *v.* Britton, 105 U. S. 322; *s. c.* 3 Nat. Bk. Cas. 48; aff'g 8 Fed. Rep. 867; Whitbeck *v.* Mercantile Nat. Bank, 127 U. S. 193; *s. c.* 3 Nat. Bk. Cas. 309; Bressler *v.* Wayne County, 25 Neb. 468; *s. c.* 3 Nat. Bk. Cas. 564; Wasson *v.* First Nat. Bank, 107 Ind. 206; *s. c.* 3 Nat. Bk. Cas. 419; Richards *v.* Rock Rapids, 31 Fed. Rep. 505; Whitney Nat. Bk. *v.* Parker, 41 Fed. Rep. 402; Mercantile Nat. Bank *v.* Shields, 59 Fed. Rep. 952. In one of its early decisions on this question the Court of Appeals of New York held that where the general statute authorizes a deduction for debts and a subsequent statute provides that the shareholder in a National bank shall be taxed on the full value of his shares, this does not authorize a claim for reduction of debts. People *v.* Dolan, 36 N. Y. 59; *s. c.* 1 Nat. Bk. Cas. 684. The same court reaffirmed this doctrine in a subsequent unreported case; but this last

But where, by a State statute, the citizen may have the amount of his indebtedness deducted from the total value of his personal property, thus ascertaining the amount of his personal estate, subject to taxation, and a subsequent statute relating to taxation of bank shares makes no provision for such deduction, the latter statute is, nevertheless, the valid rule for assessing such shares in all instances where there are no debts to be deducted. That the latter statute does not authorize a deduction for debts does not invalidate it, except as to that distinct and separable principle. Under such statutes, assessments of bank shares, where there are no debts to deduct, are valid. Even in cases of assessments where debts exist, which should be deducted, but are not, the assessments are voidable only, not void.[1] But this right to the deduction does not depend on a *demand* for it before the delivery of the tax-roll.[2]

§ **2873. Deductions for Real Estate.**— The value of the *real estate* of the bank must be deducted, when it has been considered, in arriving at the value of the shares.[3]

§ **2874. What Exemptions Constitute Unlawful Discrimination.**— The mere fact that the laws of the State exempt certain *other property* from taxation, as the laws of nearly all the States do, does not disable the State from laying a tax upon national bank shares. In order for the State exemption law to have this effect, it must be laid in such a form as to constitute a *discrimination* against capital invested in national bank shares in favor of other moneyed capital in the hands of its citizens.[4]

case was, in its turn, reversed on error by the Supreme Court of the United States, this court distinctly overruling People *v.* Dolan, *supra:* People *v.* Weaver, 100 U. S. 539, 542.

[1] Supervisors *v.* Stanley, 105 U. S. 305.

[2] Whitbeck *v.* Merchants' Nat. Bk., 127 U. S. 193; *s. c.* 3 Nat. Bk. Cas. 309.

[3] People *v.* Commissioners, 67 N. Y. 516; *s. c.* 1 Nat. Bk. Cas. 752. It is to be kept in mind that the real estate of national banks is taxable by the States by the express terms of the statute. *Ante*, § 2856.

[4] Hepburn *v.* School Directory, 23 Wall. (U. S.) 480; *s. c.* 1 Nat. Bk. Cas. 113; Lionberger *v.* Rouse, 9 Wall. (U. S.) 468; People *v.* Commissioners, 94 U. S. 415; Adams *v.* Nashville, 95 U. S. 19; *s. c.* 1 Nat. Bk. Cas. 148; 4 Wall. (U. S.) 244; *s. c.* 1 Nat. Bk. Cas. 1.

So, although individuals are not assessed on government securities, their shares in banks whose capital is invested in such securities may still be assessed.[1] An exemption of "all shares of the capital stock of any company or corporation which is required to list its property for taxation" does not include national banks whose capital is invested in government securities.[2] When State banks are exempt by statute passed before the national bank act, shares in national banks may, nevertheless, be taxed.[3] But, where a State bank has, by contract, disabled itself from taxing State banks of issue beyond a certain amount, but not its banks of discount and deposit, a tax levied on shares of all banks is valid against national banks, although greater than the State can collect of its banks of issue.[4] National banks may not be subjected to State taxation where a very material relative part of other moneyed capital in the hands of individual citizens within the same jurisdiction or taxing district is exempted from such taxation. Capital invested in national bank shares was intended by Congress to be placed upon the same footing of substantial equality in respect of taxation by State authority as the State establishes for other moneyed capital in the hands of individual citizens, however invested, whether in State bank shares or otherwise.[5]

§ 2875. Discrimination in Rate of Taxation.— Where different rates of taxation are imposed upon different classes of moneyed capital, the State may not select for national banks the highest, and may not exceed that imposed on other moneyed capital of the same class, namely, shares in State banks.[6]

§ 2876. Bank Compelled to Furnish List of Shareholders.— The State may require the cashiers of national banks to send lists of the shareholders to the assessing officers,[7] and may

[1] Lionberger *v.* Rouse, *supra*.

[2] McIver *v.* Robinson, 53 Ala. 456; *s. c.* 1 Nat. Bk. Cas. 372.

[3] Richmond *v.* Scott, 48 Ind. 568; *s. c.* 1 Nat. Bk. Cas. 445.

[4] Lionberger *v.* Rouse, *supra;* but see City Nat. Bank *v.* Paducah, 2 Flip. (U. S.) 61; *s. c.* 1 Nat. Bk. Cas. 300.

[5] Boyer *v.* Boyer, 113 U. S. 689; *s. c.* 3 Nat. Bk. Cas. 151.

[6] City Nat. Bank *v.* Paducah, 2 Flip. (U. S.) 61; *s. c.* 1 Nat. Bk. Cas. 300.

[7] Waite *v.* Dowley, 94 U. S. 527; *s. c.* 1 Nat. Bk. Cas. 137.

require them to represent the stockholders in listing and valuing the stock, although as to other personal property each owner is allowed himself to attend to it.[1] But the State cannot compel such banks to exhibit their books to furnish a basis for State taxation of the deposits.[2] Nor does the refusal of the officers to furnish a list of shareholders justify an assessment against the property of the bank.[3] A Federal court cannot stay the proceedings of a State court to compel a national bank to disclose the names of its depositors and the amounts of their deposits, for the purpose of subjecting such deposits to taxation.[4]

§ **2877. Compelling the Corporation to Pay the Tax.**— As elsewhere seen,[5] national banks may lawfully be required to pay taxes lawfully assessed against the shareholders;[6] but not in absence of express statutory authority,[7] nor where the State statute provides that they shall not be liable unless they hold dividends on property belonging to the shareholder.[8] And the property of the bank may not be seized on a warrant against "the goods and chattels of such persons."[9]

§ **2878. Legislative Correction of Assessments.**— Irregularities in the assessment may be corrected by legislative action if

[1] Whitney *v.* Ragsdale, 33 Ind. 107; 5 Am. Rep. 185; *s. c.* 1 Nat. Bk. Cas. 429.

[2] First Nat. Bank *v.* Hughes, 2 Nat. Bk. Cas. 176.

[3] Springfield *v.* First Nat. Bank, 87 Mo. 441; *s. c.* 3 Nat. Bk. Cas. 524.

[4] First Nat. Bank *v.* Hughes, 6 Fed. Rep. 737. It has been held, in the Supreme Court of the State of Washington, that *mandamus* will not lie to compel the officers of a national bank to furnish, as of June 24, the lists of stockholders required by Rev. Stat. U. S., § 5210, to be kept for inspection by taxing officers and to be revised from day to day, for the purpose of assisting an assessor to make an assessment as of April 1, especially where the assessor has, under another statute, been furnished with all the information necessary. Paul *v.* McGraw, 3 Wash. 296; *s. c.* 28 Pac. Rep. 532.

[5] *Post,* § 2914.

[6] National Bank *v.* Commonwealth, 9 Wall. (U. S.) 353; *s. c.* 1 Nat. Bk. Cas. 34; First Nat. Bank *v.* Douglas County, 3 Dill. (U. S.) 330; *s. c.* 1 Nat. Bk. Cas. 268.

[7] First Nat. Bank *v.* Herkshire, 31 Iowa, 18; *s. c.* 1 Nat. Bk. Cas. 465.

[8] Herkshire *v.* First Nat. Bank, 35 Iowa, 272; *s. c.* 1 Nat. Bk. Cas. 476.

[9] First Nat. Bank *v.* Fancher, 48 N. Y. 524; *s. c.* 1 Nat. Bk. Cas. 697. See Weld *v.* Bangor, 59 Me. 416; *s. c.* 1 Nat. Bk. Cas. 521.

intervening rights are not impaired.[1] But if the assessment is void because the persons assessed were not afforded the opportunity which the law gave them to examine and correct it, an act which gave them the right to review the assessment upon the sole ground that it is at a higher proportionate valuation than other property put on the same roll by the same officers, and does not provide for a challenge of the assessment on the ground of general over-valuation, nor permit them to make the same deduction that others are allowed to make, is void.[2]

§ 2879. **When Taxation of Shares Works an Exemption of Corporate Property.**— Where a State statute requires national bank shares to be taxed without reduction for real estate, the banking house is not taxable.[3]

§ 2880. **Taxing an Increase of Shares.**— Where there is a vote to increase the capital stock, and the shares have been issued and paid for, they may not be taxed until the increase has been approved by the comptroller of the currency.[4]

§ 2881. **Deducting Value of Real Estate.**— A bank complaining that it had been assessed on both shares and real estate,

[1] Williams *v.* Supervisors, 122 U. S. 154; *s. c.* 3 Nat. Bk. Cas. 278; aff'g 21 Fed. Rep. 99.

[2] Albany City Nat. Bank *v.* Maher, 9 Fed. Rep. 884.

[3] County Commissioners *v.* Citizens' Nat. Bank, 23 Minn. 280; *s. c.* 1 Nat. Bk. Cas. 629. It has been held that where part of the capital is invested in a banking house, and the bank pays the State tax prescribed upon the par value of all its shares, the building cannot be taxed for county purposes, although the cashier occupies a part of it as a residence. Lancaster *v.* Lancaster County Bank, 2 Nat. Bk. Cas. 415. The city of Covington, Kentucky, assessed a municipal tax upon the surplus and undivided profits, banking houses, lands bought at judicial sales to secure indebtedness, and office furniture of the plaintiff national banks. The Kentucky statutes impose an annual tax on each share of stock of $100 value in national and State banks and corporations for loans and discount. Other corporations are assessed upon their corporate property, but their stockholders are exempt from listing their shares for taxation. By the Kentucky decisions the property of State banks is held not taxable beyond fifty cents per share of $100. It was held that this rule applies to national banks, and that the real estate and furniture and surplus and undivided profits of plaintiff are exempt. Covington City National Bank *v.* Covington, 21 Fed. Rep. 484.

[4] Charleston *v.* People's Nat. Bank, 5 S. C. 103; *s. c.* 22 Am. Rep. 1; 1 Nat. Bk. Cas. 895. Compare *ante*, § 2111.

and that the value of the latter was not deducted from the gross value of the former, it appearing that the assessed valuation of both was less than half their real value, it was held that there was no cause of complaint.[1] Otherwise the value of the real estate must be deducted.[2]

§ **2882. Action to Recover Back.**— Under the statutory systems of several of the States, where an illegal tax has been compulsorily collected an action will lie for the recovery of the amount so paid,[3] and several of the cases cited in this article were actions of this kind.

§ **2883. Remedy by Injunction.**— When a rule or system of valuation is adopted by the assessors which operates unequally and is in violation of the State constitution, and is applied to a large class of individuals or corporations, equity may restrain its exercise by injunction.[4] But it has been said, in the case of a *municipal tax*, that the remedy is by action and not by injunction.[5] It has been held that, although a license tax imposed by city ordinance upon a national bank is unconstitutionl, yet the ordinance not undertaking to make the tax a lien, and giving an action of debt only for its collection, the bank is not entitled to relief by injunction.[6] But the enforcement of tax may be enjoined where the bank would be subjected to a *multiplicity of suits*.[7] One theory is, that where a bank is required by law to pay the taxes assessed on all its shares, and reimburse itself from its shareholders, it may sue to enjoin the collection of taxes

[1] Nickerson *v.* Kimball, 1 Nat. Bk. Cas. 409.

[2] City Nat. Bank *v.* Paducah, 2 Flip. (U. S.) 61; *s. c.* 1 Nat. Bk. Cas. 300; County Com'rs *v.* Farmers' &c. Bank, 48 Md. 117; *s. c.* 2 Nat. Bk. Cas. 252.

[3] For instance, in New York: National Bank *v.* Elmira, 53 N. Y. 49; *s. c.* 1 Nat. Bk. Cas. 715.

[4] Cummings *v.* National Bank, 101 U. S. 153; *s. c.* 2 Nat. Bk. Cas. 74; Pelton *v.* National Bank, 101 U. S. 143; *s. c.* 2 Nat. Bk. Cas. 85; 21 Alb. L. J. 236; First Nat. Bank *v.* Richmond, 39 Fed. Rep. 309; Hills *v.* Exchange Bank, 105 U. S. 319; *s. c.* 3 Nat. Bk. Cas. 45.

[5] National Com. Bank *v.* Mobile, 62 Ala. 284; *s. c.* 34 Am. Rep. 15; 2 Nat. Bk. Cas. 440. *Contra*, Macon *v.* First Nat. Bank, 59 Ga. 648; *s. c.* 1 Nat. Bk. Cas. 219.

[6] Second Nat. Bank *v.* Caldwell, 13 Fed. Rep. 429.

[7] City Nat. Bank *v.* Paducah, 2 Flip. (U. S.) 61; *s. c.* 1 Nat. Bk. Cas. 300; Merchants' Nat. Bank *v.* Cumming, 1 Nat. Bk. Cas. 926; Albany City Nat. Bank *v.* Maher, 6 Fed. Rep. 417.

illegally assessed, as it stands in the relation of a trustee, and such suit will save multiplicity of actions.[1] So, on the ground of preventing *irreparable damage*, it has been held that where there is no means of recovering back a tax illegally collected, a court of equity will prohibit its collection;[2] but not where assessors arrived at a correct result by erroneous methods;[3] nor unless there is an *offer to pay the proper tax*, and not when the effect would be to avoid the whole State tax for the year;[4] the proper mode of proceeding being to pay or tender the lawful amount, and sue for an injunction to restrain the collection of the balance.[5] An action to enforce a right conferred by the Federal statute[6] is a suit arising "under the laws of the United States," within the meaning of the act of March 3, 1875.[7] The suit for the injunction is maintainable in a Federal court under the act of 1882.[8] It may be maintained by the bank on behalf of the shareholder; or on behalf of a shareholder entitled to a deduction and who had demanded it in conformity to the State law; or even without such demand when it would have been unavailing.[9]

§ **2884. Construction of Various State Statutes.**— Statutes of Iowa, Massachusetts, Illinois, Maine, Ohio, New York, Montana, New Jersey, California, North Carolina, are construed by the authorities cited in the note below.[10]

[1] Whitney Nat. Bk. *v.* Barker, 41 Fed. Rep. 402.

[2] First Nat. Bank *v.* Douglas County, 3 Dill. 330; *s. c.* 1 Nat. Bk. Cas. 268.

[3] St. Louis Nat. Bank *v.* Papin, 4 Dill. 29; *s. c.* 1 Nat. Bk. Cas. 326.

[4] National Bank *v.* Kimball, 103 U. S. 732; *s. c.* 3 Nat. Bk. Cas. 9.

[5] People *v.* Weaver, 100 U. S. 539; *s. c.* 2 Nat. Bk. Cas. 57; Pelton *v.* National Bank, 101 U. S. 143; *s. c.* 2 Nat. Bk. Cas. 85; 21 Alb. L. J. 232; Whitney Nat. Bk. *v.* Parker, 41 Fed. Rep. 402.

[6] *Ante*, §2856.

[7] Stanley *v.* Board of Supervisors, 6 Fed. Rep. 561.

[8] Union Nat. Bank *v.* Miller, 15 Fed. Rep. 703.

[9] Hills *v.* Exchange Bank, 105 U. S. 319; *s. c.* 3 Nat. Bk. Cas. 45.

[10] Morseman *v.* Younkin, 27 Iowa, 350; *s. c.* 1 Nat. Bk. Cas. 460; Providence Institution *v.* Boston, 101 Mass. 575; *s. c.* 1 Nat. Bk. Cas. 578; McVeagh *v.* Chicago, 49 Iowa, 318; *s. c.* 1 Nat. Bk. Cas. 381; Weld *v.* Bangor, 59 Me. 416; *s. c.* 1 Nat. Bk. Cas. 521; Cummings *v.* Merch. Nat. Bank, 101 U. S. 153; *s. c.* 2 Nat. Bk. Cas. 74; *s. c.* below, 1 Nat. Bk. Cas. 926; McMahon *v.* Palmer, 102 N. Y. 176; *s. c.* 55 Am. Rep. 796; 3 Nat. Bk. Cas. 636; Supervisors *v.* Stanley, 105 U. S. 305; *s. c.* 3 Nat. Bk. Cas. 33; Davenport Bank *v.* Board of Equalization, 123 U. S. 83; *s. c.* 3 Nat. Bk. Cas. 285;

Article VI. Taxation of Dividends.

§ **2890. Policy of Laying Taxes on Dividends.**— Some of the States have pursued the policy of laying taxes upon dividends declared by corporations, and this has been a favorite method of taxation, especially with regard to banking corporations. In some cases the taxes thus laid have been *graduated* according to the amount of the dividend. Several of the statutes of Pennsylvania laying such taxes are referred to in the opinion of Agnew, J., in a case in that State,[1] from which it appears that in one of these acts relating to banking companies such

aff'g 64 Iowa, 140; Williams *v.* Supervisors, 122 U. S. 154; *s. c.* 3 Nat. Bk. Cas. 278; aff'g 21 Fed. Rep. 99; Com'rs. *v.* Davis, 6 Mont. 306; *s. c.* 3 Nat. Bk. Cas. 546; Mercantile Bank *v.* New York, 121 U. S. 138; *s. c.* 3 Nat. Bk. Cas. 243; aff'g 28 Fed. Rep. 776; Newark Banking Co. *v.* Newark, 121 U. S. 163; *s. c.* 3 Nat. Bk. Cas. 265; Miller *v.* Heilbron, 58 Cal. 133; *s. c.* 3 Nat. Bk. Cas. 330; McAden *v.* Commissioners &c., 97 N. C. 355; *s. c.* 3 Nat. Bk. Cas. 694; Stanley *v.* Supervisors, 121 U. S. 535; *s. c.* 3 Nat. Bk. Cas. 268; Whitbeck *v.* Mercantile Nat. Bank, 127 U. S. 193; *s. c.* 3 Nat. Bk. Cas. 309; Bank *v.* Boston, 125 U. S. 60; *s. c.* 3 Nat. Bk. Cas. 300.

[1] Phœnix Iron Co. *v.* Commonwealth, 59 Pa. St. 104.

impositions were laid in an increasing gradation until the tax arose to a thirty per cent tax on a twenty-five per cent dividend, — that is to say, if a corporation declared a dividend equal to one-fourth of its capital stock, the State thought that its shareholders were enjoying sufficient profits to enable the State to take three-tenths of this one-fourth to swell its revenues.

§ **2891. The Standard by Which to Determine What is a Dividend under Such Statutes.**— Much difficulty has arisen in fixing any standard by which to determine what is to be deemed a dividend upon which the tax against the corporation is to be admeasured, under such a statutory scheme of taxation. The conclusion seems to be, that whatever is actually divided to shareholders of the increment of the business of the corporation in excess of its actual capital, is to be regarded as a dividend for these purposes; [1] and on the other hand, profits which are neither divided nor capitalized, but which are carried to profit and loss account, are not to be regarded as dividends for the purposes of admeasuring such a tax. Thus, it was said by a very able judge at *nisi prius* (Simonton, P. J.), in language approved by the supreme court on error, that "the theory of the act is, that the profits realized by the corporation, whether directly arising from its operation from year to year, or from the increase in the value of its property from whatever cause, will sooner or later reach the pockets of the stockholders; and that when they do, they furnish a fair measure of the value of the capital stock, and therefore the amount of the tax which it ought to pay." [2]

§ **2892. Distinction between a Tax on Dividends and a Tax on Capital.**— As the capital stock of a corporation belongs to the corporation, and not to the shareholders,[3] and as a dividend when declared belongs to the shareholders distributively, in proportion to their holdings of the shares,[4] — there should, in general, be no difficulty in determining, in the construction of a

[1] Matson's Ford Bridge Co. *v.* Commonwealth, 117 Pa. St. 265.

[2] Matson's Ford Bridge Co. *v.* Commonwealth, 117 Pa. 265, 275. Circumstances under which *rents* payable by lessee to lessor corporation are taxable as dividends. Atlantic &c. Tel. Co. *v.* Commonwealth, 66 Pa. St. 57, 62.

[3] *Ante,* §§ 1066, 1071.

[4] *Ante,* §§ 2131, 2228.

given statute, whether the tax thereby laid is to be deemed a tax upon capital or a tax upon dividends. Such a question was, however, raised in a case in Pennsylvania on the provisions of two successive revenue statutes. The first of these opened with the declaration "that the amount of tax chargeable on the capital stock of all institutions and companies incorporated by or under any law of this Commonwealth, on a dividend or profit of six per cent per annum or more, which shall be made and declared, shall be at the rate of one-half mill on each one per cent of such dividend or profit," etc.[1] The second of these statutes opened with the declaration: "The capital stock of all banks, savings institutions, and companies whatever, incorporated by or under any law of this Commonwealth, shall pay a tax into the treasury of the Commonwealth annually, at the rate of one-half mill for each one per cent of a dividend made or declared by such bank, saving institution, or company."[2] The court, after a comparison of the general course of the statute law of the State in regard to the laying of taxes upon dividends, concluded that the tax laid by these statutes was a *tax upon the capital stock*, and not a tax on dividends, although measured by the rate of their dividends;[3] and this doctrine has been reaffirmed in subsequent cases.[4]

§ 2893. Distinction between a Tax on Dividends and a License Tax.— A recent Federal case may, perhaps, be referred to as illustrating a distinction which may be taken between a *license tax* for the privilege of carrying on business as a corporation and a tax on dividends, — illustrating what is shown by the preceding section, that the mere fact that a tax is graduated or measured by the dividend declared by the corporation does not make it a tax on dividends.[5] Taxes of this nature were never regarded as a tax upon *dividends* in that State, but were regarded as a *license tax* or fee, exacted by the State from the corporations therein named, for the privilege of continuing to exercise

[1] Pa. Act of April 29, 1844, § 33.

[2] Pa. Act of April 12, 1859, § 1.

[3] Phœnix Iron Co. *v.* Commonwealth, 59 Pa. St. 104.

[4] See, for instance, Matson's Ford Bridge Co. *v.* Commonwealth, 117 Pa. St. 265, 276. The statute was explained the same way in Lehigh Crane Iron Co. *v.* Commonwealth, 55 Pa. St. 448, 455.

[5] Jersey City Gas Light Co. *v.* United Gas Imp. Co., 46 Fed. Rep. 264, 268.

their corporate franchises.[1] It was not regarded as a franchise tax admeasured according to the dividends declared, because the declaration of dividends rests in the discretion of the directors,[2] and is influenced by such a variety of considerations as to afford no single standard for the admeasurement of such a tax; and consequently the statute evinced no attempt to measure the tax according to the value of the franchise. It was held to be not a tax upon either real or personal property, franchises, capital stock, or gross receipts. It followed that a gas company of Pennsylvania, which had leased the property of a gas company of New Jersey, subject to this tax, had not become liable to pay the tax under the following clause in the contract of lease: "The party of the second part shall also pay all assessments and taxes which may be lawfully assessed or levied upon the real and personal property, franchises, capital stock, or gross receipts of the party of the first part during the continuance of this agreement."[3]

§ **2894. Franchise Tax Admeasured upon Dividends.**— The legislature of New York, in 1880, passed a statute similar to those of Pennsylvania already referred to, involving the principle of laying a so-called *franchise tax* upon certain corporations and associations, to be laid and collected in the form of a tax upon their dividends. The statute provided that every corporation (with certain exceptions) should pay into the treasury of the State a tax upon its corporate franchise, to be computed as follows: If the dividend or dividends made or declared by said corporation, etc., during any year ending with the first day of November, amount to six or more than six per centum upon the par value of its stock, then the tax shall be at the rate of one-fourth of a mill on the capital stock for each one per centum of dividends so made or declared. Or, if no dividend should be made or declared, or if the dividend made or declared should not amount to six per centum upon the par value of the capital stock, then the

[1] Standard &c. Cable Co. *v.* Attorney-General, 46 N. J. Eq. 270, 273; *s. c.* 19 Am. St. Rep. 394; 19 Atl. Rep. 733; State *v.* Assessors, 47 N. J. L. 36; Press Printing Co. *v.* Assessors, 51 N. J. L. 75; *s. c.* 16 Atl. Rep. 173; followed in Jersey City Gas Light Co. *v.* United Gas Imp. Co., 46 Fed. Rep. 264.

[2] *Ante*, § 2128.

[3] Jersey City Gas Light Co. . United Gas Imp. Co., 46 Fed. Rep. 264, 268.

tax shall be at the rate of one-half mill upon each dollar of the valuation of the capital stock, etc.[1] This was held to be a *franchise tax*, to be laid annually, and the amount of dividends made and declared during the year was merely a mode of measuring the tax. The theory of the statute was said to be that, "as dividends can be legally made only out of earnings or profits, and cannot be made out of capital, they are assumed to approximate as nearly as practicable the just measure of the tax which should be imposed upon the corporation for the enjoyment of its franchise."[2] An insurance company having a large surplus on hand, all of which had been earned and acquired prior to the passage of this statute, having in contemplation the expiration of its charter, which would soon take place, took the sum of $100,000 from its surplus fund and divided it among its shareholders, and at the same time resolved that its charter should be extended. It was held that this was not such a dividend of profits as was contemplated by the statute, and that no tax was leviable against the company in respect of it.[3]

§ 2895. Taxing Prospective Dividends to the Corporation.— While a dividend which has been declared but not paid belongs to the shareholders distributively,[4] and is in strictness taxable against them, although in form the tax may be assessed against the corporation and collected from it,—yet we have the authority of one case for concluding that that nondescript species of dividend, which consists in declaring a so-called dividend and then reserving it and paying interest upon it to the shareholder, is taxable to the corporation as an element to be included in making up the value of its taxable *franchise*.[5]

§ 2896. Taxing the Corporation on Dividends Already Declared and Paid.— Adhering to the principle that when a dividend is declared, the money, so set apart and segregated from the surplus funds of the corporation, becomes the property of the shareholders distributively, and is held in trust for

[1] Laws of New York, 1880, ch. 542, as amended by N. Y. Laws of 1881, ch. 361.

[2] People *v.* Albany Insurance Co., 92 N. Y. 458, 461.

[3] *Ibid.*

[4] *Ante*, §§ 2131, 2228.

[5] Boston &c. R. Co. *v.* Commonwealth, 100 Mass. 399.

them by the corporation until it is paid,[1] it may be concluded that, after a dividend has been thus declared, the legislature of a State has no power to pass an act laying a tax *upon the corporation* in respect of such dividend; for this would not be to tax the corporation in respect of its property, but in respect of the property of some one else. It would be, in substance and effect, the same as compelling A. to pay a tax upon a farm or a chattel belonging to B. If it could be assumed that the legislature possesses the power, by a retrospective law, of compelling a corporation to pay a tax upon a dividend already declared, a statute will not be interpreted as intended to have this effect, unless such interpretation is unavoidable. This is more clear where, at the time of the passage of the act, the dividends to which it is sought to be applied as against the corporation have not only been declared but *have been paid.* Thus, the legislature of Alabama passed a revenue law which was approved and became operative on the 31st day of December, 1868. This law authorized the imposition of a tax of three-fourths of one per cent "on all dividends declared or earned and not divided by incorporated companies created under the laws of this State, to be assessed and paid by the companies earning the same." In July of that year an insurance company declared a dividend of its earnings and profits, of $27,000, and divided it among its shareholders, a few of them receiving payments in cash, but most of them receiving it in the form of credits upon notes which they had given in settlement of their indebtedness to the corporation for their shares. It was held, and on the plainest grounds, that the statute did not authorize or purport to authorize a tax upon dividends which had been *declared and paid*, and that the imposition of the tax was illegal.[2]

§ 2897. Taxing Dividends Paid in Reduction of Capital. — The distribution which a corporation makes among its stockholders of the funds accumulated as capital for a particular purpose, under a resolution providing for a reduction of the par value of the capital stock, has been held not to be a dividend within the meaning of a statute of Pennsylvania[3] subjecting

[1] *Ante*, §§ 2131, 2228.

[2] Citizens' Mut. Ins. Co. *v.* Lott, 45 Ala. 185.

[3] Pa. Act 1879, p. 112, § 4.

capital stock to a taxation to be admeasured upon dividends declared by the corporation.[1]

§ 2898. Taxing Dividends Arising from Damages for Condemnation of the Property of the Corporation. — In determining what is to be regarded as a dividend, within the meaning of a statute,[2] upon which a tax against the capital of a corporation is to be admeasured in the system of taxation in Pennsylvania already referred to, it has been held that where a bridge belonging to an incorporated bridge company has been condemned for public use, by being declared a county bridge under another statute; and damages have been awarded to the company for its expropriation, which damages, in the aggregate, are in excess of the capital stock of the company; and the company, electing substantially to discontinue its business as a corporation, divides the sum so awarded among its stockholders in proportion to the shares held by each, — so much of the sum thus divided as is in excess of the capital stock of the company represents a profit which the company has made in its business, and which is taxable under the statute.[3]

§ 2899. Taxing the Dividends of Non-resident Stockholders. — The Supreme Judicial Court of Massachusetts have held that the statute of that State providing that every corporation organized under a charter, or under general statutes, should reserve from each dividend one-fifteenth part of that portion thereof which was due and payable to its stockholders residing out of the commonwealth, and should pay the same as a tax or excise on such estate or commodity to the treasurer of the commonwealth, — is unconstitutional and void. If the imposition was regarded as a tax, then it was prohibited by that clause of the constitution of Massachusetts which required taxes to be "reasonable and proportional." It was an arbitrary imposition, imposed upon non-resident shareholders merely. No such imposition was imposed upon resident shareholders; nor were

[1] Commonwealth *v.* Central Transp. Co., 145 Pa. St. 89; 22 Atl. Rep. 209.

[2] Pa. Act of June 7, 1879, § 4.

[3] Matson's Ford Bridge Co. *v.* Commonwealth, 117 Pa. St. 265; *s. c.* 20 Am. & Eng. Corp. Cas. 604; 11 Atl. Rep. 813; 10 Cent. Rep. 809.

resident shareholders taxed in such a manner that this imposition upon non-residents could be regarded as "proportional" in respect of the tax laid upon the shares of residents. If it was to be regarded not as a tax, but as an excise, it was still, within a previous decision of the court,[1] beyond the power of the legislature to enact it, because it was grossly unequal and contrary to the principles of justice. As the machinery of manufacturing corporations, for instance, was taxed as tangible property in Massachusetts, the result of this imposition was "that the excise is not only imposed upon dividends due to one class of stockholders, and not on those due to another class in the same corporation, but a higher rate of excise is paid by non-resident stockholders in one class of corporations than by foreign stockholders in all other corporations." The tax was also held to be violative of that provision of the constitution of the United States,[2] which secures to the citizens of each State all privileges and immunities of citizens of the several States.[3]

§ **2900. Taxing the Dividends of Foreign Corporations.** — There is an unsatisfactory decision of the Court of Appeals of New York upholding a statute laying a tax upon the dividends of certain corporations, *foreign* and domestic, "doing business within this State." So much of the statute as is important is as follows: "Every corporation, joint-stock company, or asso-

[1] Referring to Portland Bank *v.* Apthorp, 12 Mass. 252, 255.

[2] Const. U. S., art. IV., § 2.

[3] Oliver *v.* Washington Mills, 11 Allen (Mass.), 268. The opinion in this case was written by Bigelow, C. J., a judge whose opinions seem not to have been held in proper estimation, either in Massachusetts or elsewhere. The opinions of this judge are always very strong and clear. His diction is perfect. As a judge, he was the equal, if not the superior, of Shaw. On the proposition that the tax was violative of the Federal constitution, the learned judge cited: Corfield *v.* Coryell, 4 Wash. (U. S.) 380, 381; Campbell *v.* Morris, 3 Har. & McH. (Md.) 535, 554; Crandall *v.* State, 10 Conn. 339, 343. These cases support the general proposition that a taxing law of a State, exempting its own citizens from taxation or excise, to which citizens of other States are subjected, violates the provision of the Federal constitution above referred to. In Ward *v.* Maryland, 12 Wall. (U. S.) 418, 430, it is said: "It will be sufficient to say that the clause plainly and unmistakably secures and protects the right of a citizen of one State * * * to be exempt from any higher taxes or excises than are imposed by the State upon its own citizens." See also *post*, Ch. 117, Art. 3.

ciation whatever, * * * now or hereafter incorporated or organized by or under any law of any other State or country, and doing business in this State," etc., "shall be subject to and pay a tax, as a tax upon its corporate franchise or business, into the treasury of the State annually, to be computed as follows: If the dividend or dividends made or declared by such corporation, joint-stock company, or association, during any year ending with the first day of November, amount to six or more than six per centum upon the par value of its capital stock, then the tax to be at the rate of one-quarter mill upon the capital stock for each one per centum of dividends so made or declared; or if no dividend be made or declared, or if the dividend or dividends made or declared do not amount to six per centum upon the par value of said capital stock, then the tax to be at the rate of one and one-half mills upon each dollar of valuation of the said capital stock made in accordance with the provisions of the first section of this act."[1] It was held that this statute was valid in so far as it laid a tax upon a foreign corporation doing business within the State, and that it was a tax on the *business* of such corporation, although admeasured upon its dividends, —although the tax was not apportioned upon the amount of dividends earned *within the State*, or upon the amount of capital stock employed *within the State*.[2]

§ 2901. Dividing the Dividend Payable within Any Year so as to Defeat Taxation. — Where the governing statute lays a tax upon the corporation admeasured by any dividend which it may declare in excess of six per centum upon its capital stock, the corporation cannot, it has been justly held, defeat the statute by dividing up its dividend and declaring in the course of the year *fractional dividends*, each one being a dividend of less than six per cent; but the dividend which is taxable under such a statute is to be measured upon the aggregate of dividends

[1] Laws N. Y. 1880, ch. 542; as amended by *Id.* 1881, ch. 361.

[2] People *v.* Equitable Trust Co., 96 N. Y. 387. See also People *v.* Horn Silver Mining Co., 105 N. Y. 76, 84. Compare Home Insurance Co. *v.* New York, 134 U. S. 594; affirming *s. c.* 92 N. Y. 328, where the corporation contesting the tax was a *domestic* company and where the tax was held valid.

declared within the revenue year, whether the statute says so in terms or not.[1]

§ **2902. Illustration.**— This is well illustrated by a case in Pennsylvania which was determined under a statute which bears on its face the finger-marks of some lawyer whose mind had been sharpened, but not enlarged, by the practice of his profession. Two incorporated passenger railroad companies were merged and consolidated under the title of the Ridge Avenue Passenger Railroad Company, and the consolidation was confirmed by an act of the legislature of Pennsylvania. This statute authorized an increase of the capital stock of the consolidated company, and authorized the directors to declare dividends of the profits "at such time or times as they may deem expedient"; but with the proviso "that the said company shall only pay into the treasury of the city of Philadelphia, for the use of said city, a tax of six per cent upon so much of *any dividend declared* which may exceed six per centum upon their capital stock." It was held that the provision for the payment of an annual tax on "any dividend declared," etc., contemplated that a tax should be laid upon the aggregate of dividends declared in any one year, and not on any single dividend. The company, from January, 1875, to October, 1879, having declared numerous dividends, no one of which exceeded six per cent upon its capital stock paid in, but the total dividend in each year did largely exceed that amount,—it was held that it was liable to pay a tax of six per cent upon the excess of such aggregate of annual dividends. The statute was manifestly concocted to enable the consolidated railroad company, by declaring frequent dividends during the year, each one of which should be less than six per cent, to declare large dividends to its stockholders, and at the same time evade the payment of any tax thereon; and it was evidently unwittingly enacted by the legislature in the frame of language employed. In disregarding its letter and reaching this just result, the Supreme Court of Pennsylvania proceeded upon the proposition that where a literal construction of certain words in a statute imposing a tax upon the dividends of a corporation would place it within the power of the directors to declare dividends in such a manner as to escape all taxation, such construction will not be adopted, if the act is reasonably susceptible of any other construction whereby the revenue may be secured.[2]

[1] Conceded in People *v.* Albany Ins. Co., 92 N. Y. 458, 462. So held in Philadelphia *v.* Ridge Ave. Passenger R. Co., 102 Pa. St. 190.

[2] Philadelphia *v.* Ridge Avenue Pass. R. Co., 102 Pa. St. 190.

§ 2903. Corporation Estopped by its Own Declaration of Dividends. — Although the State may not be bound by the declaration of dividends which the corporation makes — that will depend upon the terms of the particular statute,— yet it is perfectly clear that the corporation itself will be estopped, by its own declaration of dividends, from disputing that such were the proper dividends upon which a tax laid upon dividends, or upon capital stock and admeasured by the amount of dividends, was to be assessed.[1]

§ 2904. Taxation of Dividends Declared through Mistake.— Hence, if a *national bank*, in good faith, but by mistake, declares a dividend or makes an addition to its surplus or contingent funds, when it is not in a condition to do so, the dividend or addition is subject to *Federal taxation*, and the mistake cannot be corrected by the courts by way of permitting a recoupment, so to speak, in an action brought against the bank by the United States to recover the tax; nor can it be recalled or rescinded after the time comes for the bank to make its return to the assessor.[2]

§ 2905. Taxation of Stock Dividends. — Under the Pennsylvania statutes already referred to, by which the capital stock of corporations is taxable, in respect of the amount of dividend which the corporation declares, in the form of a percentage upon the dividends,[3] it has been held that what are called *stock dividends* are to be taken into consideration in admeasuring such a tax, equally with cash dividends.[4] By this is meant dividends which the company declares out of its profits, but which it pays by *issuing new shares* to its members in proportion to their holdings of existing shares, instead of making a payment in cash,— thus capitalizing a portion of its profits, increasing its share

[1] Citizens' Passenger R. Co. *v.* Philadelphia, 49 Pa. St. 251; Atlantic &c. Tel. Co. *v.* Commonwealth, 66 Pa. St. 57; Commonwealth *v.* Pittsburg &c. R. Co., 74 Pa. St. 83; Bailey *v.* Railroad Co., 106 U. S. 109, 115; Central Nat. Bank *v.* United States, 137 U. S. 355, 365.

[2] Central Nat. Bank *v.* United States, 137 U. S. 355; affirming *s. c.* 24 Fed. Rep. 527, which reversed *s. c.* 15 Fed. Rep. 223.

[3] *Ante*, § 2892.

[4] As to the nature of such dividends, see *ante*, § 2167, *et seq.*

capital, and issuing shares in respect of the profits capitalized.[1] It has been further held, but upon seemingly unsatisfactory grounds, that where a corporation, without capitalizing its surplus by a formal resolution, and issuing shares of stock to represent it, merely *invests it in improvements*, the amount so invested is to be regarded as a dividend for the purpose of admeasuring such a tax.[2]

§ 2906. When Founded on a Mere Formal Increase of Capital. — On the other hand, where the corporation merely makes a *formal increase* of its capital stock and issues new shares to its members, thus changing the *denomination*, but not the *proportions*, of their holdings,— but without dividing any increment among them,— this, it has been held, though in form a stock dividend, is not in substance and fact a dividend of profits upon which a tax can be admeasured. For instance, a railroad company leased its roads to another corporation for 999 years, at a rental of twelve per centum per annum of its capital. The lessor company increased the number of its shares seventy-one per cent, the par value of both the original and increased shares remaining at $50. On this increased stock the stockholders were to receive seven per cent, this being the same amount which they would have received on the original number of shares at twelve per cent. It was held that the capital of the company was not subject to state taxation, to be admeasured upon its increase of stock, on the theory of its being a dividend on profits.[3]

[1] Commonwealth *v.* Cleveland &c. R. Co., 29 Pa. St. 370.

[2] Lehigh Crane Iron Co. *v.* Commonwealth, 55 Pa. St. 448, 451.

[3] Commonwealth *v.* Pittsburg &c. R. Co., 74 Pa. St. 83, 92. On the subject of the taxation of *scrip dividends*, two decisions of the Supreme Court of the United States in a case arising under section 122 of the Federal Internal Revenue Law as enacted in 1864 and amended in 1866 (13 U. S. Stat. at Large 284; as amended by act of July 13, 1866; 14 *Id.* 138), may furnish analogies for the decision of similar questions arising under other statutes. The first held, and seemingly on the soundest grounds and on the most obvious meaning of the statute, that interest-bearing scrip, distributed among the shareholders of a railroad company to represent profits which had been used in improving and extending its property, constituted a scrip dividend within the meaning of the statute, and was taxable as such. Bailey *v.* Railroad Co., 22 Wall. (U. S.) 604. The second, which arose on a second writ of error in the same case, construes the statute as intending to confine the tax to dividends of *annual* profits, a meaning which can

§ 2907. When Tax Measured by Dividend on Paid-up Capital.— Under the scheme of taxing capital by admeasuring the tax on dividend in vogue in Pennsylvania,[1] it has been held that the tax is properly measured upon dividends declared *on the paid-up capital* of a company; and the words "capital stock," providing for the tax admeasured on dividends, have been held to refer to the stock actually subscribed and paid in, and not to *potential* or *authorized* capital stock.[2] This is especially true where the charter or governing statute merely lays a tax upon dividends when they exceed a certain per cent per annum. If, under such a statute, the dividends were computable upon nominal or theoretical capital, the corporation could, by merely increasing its theoretical capital, keep the dividends below the statutory per centum and defeat the payment of the tax entirely.[3]

§ 2908. Taxation of Corporate Property Represented by Interest-bearing Stock Certificates.— The qualities of interest-bearing share certificates have already been considered in different relations.[4] It remains now to refer to decisions to the effect that the issuing by a corporation of share certificates which recite in substance that the stockholders named therein have an interest in the property of the corporation to the amount therein specified, upon which the company agrees to pay interest, reserving the right to redeem the certificate upon ten days' notice, by paying the amount in money or in stock, does not affect the statute and the undistributed surplus profits of the corporation which may be supposed in some way to be represented by such certificates. The certificates are looked upon, not

nowhere be found in the language of the act, and which gives away the rights of the government to the railroad company in a manner calculated to excite painful reflections. Bailey *v.* Railroad Co., 106 U. S. 109, Mr. Justice Harlan, dissenting. That the tax on *dividends* under section 120 of the same act as amended by the act of July 13, 1866, covered amounts retained by the corporation to pay State taxes assessed against the shares: Central National Bank *v.* United States, 137 U. S. 355; affirming *s. c.* 24 Fed. Rep. 577, which reaffirmed *s. c.* 15 Fed. Rep. 222.

[1] *Ante*, §§ 2890, 2892.

[2] Philadelphia *v.* Ridge Ave. Passenger R. Co., 102 Pa. St. 190.

[3] Citizens' Passenger R. Co. *v.* Philadelphia, 49 Pa. St. 251, 255. The courts say, among other forcible things, that "dividends were due to capital and not to mere moonshine."

[4] *Ante*, §§ 2239, 2362.

as a division of any surplus profits *in præsenti*, but as an agreement to divide at some future time. They are not regarded as creating an indebtedness, since they do not entitle their holders, of their own mere will, to demand from the corporation the payment of any sum except the semi-annual installments of interest. The conclusion is, that whatever surplus exists in the hands of the company is liable to an assessment for taxes as the property of the company, notwithstanding the fact that such certificates, to a larger amount than the surplus, may be outstanding.[1]

ARTICLE VII. QUESTIONS RELATING TO ASSESSMENT AND COLLECTION.

§ 2913. Certainty of Description in Assessment: "Mining Stock" — "Bank Stock." — The rule as to the degree of certainty required in describing personal property in assessments for taxation is said to be, that the property shall be so described that the tax payer may *know for what he is being taxed.*[2] It is further to be observed that it is probable that the revenue laws of all the States require property owners to list and return their property for taxation, and provide that where this is not done the assessors shall make the assessment from the best information they can get, sometimes adding penalties for the delinquency of the property owner. In dealing with the question of the sufficiency of description of personal property in a tax assessment, it has been well observed, in view of the existence of such a

[1] People *v.* Assessors, 76 N. Y. 202; affirming *s. c.* 16 Hun (N. Y.), 196. To the same effect, see People *v.* New York Tax Com'rs, 28 Hun (N. Y.), 261. Stock dividends not taxable under Federal Revenue Act of 1862,—see Chicago &c. R. Co. *v.* Page, 1 Biss. (U. S) 461.

[2] San Francisco *v.* Flood, 64 Cal. 504, 506; People *v.* Home Ins. Co., 29 Cal. 534, 540; Goddard *v.* Seymour, 30 Conn. 394, 397; Hamersley *v.* Franey, 39 Conn. 176; Monroe *v.* New Canaan, 43 Conn. 309, 312; Adam *v.* Litchfield, 10 Conn. 127, 131

statute: "The description in question was made either from a list furnished by defendant, or some one on his behalf and by his authority; or, no list having been so furnished, it was of necessity made by the assessor. If the description was taken from a list furnished by the defendant, or some one on his behalf and by his authority, he ought not to be heard to complain of the insufficiency of the description. If made by the assessor without the aid of such list, the assessor has given a description as certain as could reasonably be required of him, and under such circumstances the defendant's objection to the assessment should not be regarded."[1] These premises considered, it may readily be concluded that the most general words of description will be held sufficient. Accordingly, it has been held, under a statute enacting that the assessment-roll or book shall show "all personal property, showing the number, kind, amount, and quality, but a failure to enumerate in detail such personal property does not invalidate the assessment,—"[2] that a description as general as "mining stock" is allowable,— the court adding: "The words used in the statute were intended to authorize the assessor to do just what was done here."[3] In another State an assessment describing certain personalty as "twenty bank stock, $2,000," was held sufficient as a description of twenty shares of bank stock, under a statute requiring that "shares owned by any person resident in this State, of the capital stock of any bank," etc., be set in the list of such owner.[4]

§ 2914. Assessing upon the Corporation a Tax against Shareholders.— Many statutory schemes of taxation, for the sake of greater certainty and convenience in assessing and collecting taxes upon shares, pursue the plan of assessing such taxes in the aggregate against the corporation, of compelling the cor-

[1] San Francisco *v.* Flood, 64 Cal. 504, 506, opinion by Thornton, J.

[2] Cal. Pol. Code, § 3650, sub. 4.

[3] San Francisco *v.* Flood, 64 Cal. 504.

[4] Monroe *v.* Town of New Canaan, 43 Conn. 309, 312. In People *v.* McCreery, 34 Cal. 432, 434, the words "money loaned" were held a sufficient description. In People *v.* Sneath, 28 Cal. 612, the words "personal property" were held to convey a sufficient description. In Falkner *v.* Hunt, 16 Cal. 167, it was said that an assessment stating the different kinds of personal property would be a compliance with the statute. See also People *v.* Holladay, 25 Cal. 300.

poration to make payment, and of allowing the corporation to deduct the same from dividends accruing to the shareholders, or giving it a lien upon their shares, or giving it a right of action against them, or some other legal remedy for its reimbursement by them. It has been held in many cases that there is no constitutional or other objection against such a statute.[1] This mode of assessing taxation was adopted by an act of Congress in respect of *railroad mortgage bonds*, assessing directly against the company the tax laid against the bondholders, requiring the company to pay the tax, and authorizing it to deduct and withhold the same from all payments on account of interest or coupons.[2] It was held valid in respect of State taxation of shares of *national banking associations*, by the Supreme Court of the United States.[3]

§ **2915. Statutes under Which This Mode of Taxation not Applied.** — On the other hand, statutory systems are found under which this mode of taxation is held inadmissible. In some States this method has existed, but has been abandoned by subsequent legislation. Such is the case in Tennessee, where the act of 1873 changing, it seems, the prior mode of assessing for taxation corporate shares, enacted that "no tax shall hereafter be assessed upon the capital of any bank or banking association * * * organized under the authority of this State, or of the United States; but the stockholders in such banks * * * shall be assessed and taxed on the value of their shares of stock therein," etc.[4] So, the Supreme Court of Missouri in 1860 erroneously construed the national banking act

1 Ottawa Glass Co. *v.* McCaleb, 81 Ill. 556, 559; Street Railroad Co. *v.* Morrow, 87 Tenn. 406; *s. c.* 11 S.W. 348; 2 L. R. A. 853; Maltby *v.* Reading &c. R. Co., 52 Pa. St. 140; Delaware &c. R. Co. *v.* Commonwealth, 66 Pa. St. 64, 69; Commonwealth *v.* Lehigh Valley R. Co., 104 Pa. St. 89, 106; Commonwealth *v.* Delaware &c. Canal Co., 123 Pa. St. 594, 618; *s. c.* 16 Atl. 584; 2 L. R. A. 798; 46 Phila. Leg. Int. 191; 23 W. N. C. 216; New Orleans *v.* Louisiana Savings Bank, 31 La. An. 826. See also Commonwealth *v.* New York &c. R. Co., 145 Pa. St. 38; 22 Atl. Rep. 212.

2 Haight *v.* Railroad Co., 6 Wall. (U. S.) 15.

3 National Bank *v.* Commonwealth, 9 Wall. (U. S.) 353, 363. The doctrine of this case was recognized some years later in Cummings *v.* National Bank, 101 U. S. 156.

4 Thomp. & S. Tenn. Code, § 541*c*; State *v.* Butler, 86 Tenn. 614; *s. c.* 8 S. W. Rep. 586, 592.

as requiring that any tax imposed by State authority on shareholders in national banking associations be assessed specifically against the shareholders, and not against the capital of the bank. It held that the applicatory revenue statute of Missouri was in consonance with the act of Congress in this respect.[1] So, a similar statute of Louisiana, providing for a similar mode of assessment and collection of taxes laid upon the shares of corporations, was held not to apply to corporations which were not organized for direct pecuniary gain, such as the New Orleans Cotton Exchange.[2] So, it has been held in two cases by the Circuit Court of the United States for the Eastern District of Virginia (and this is possibly what was meant by the Missouri decision above quoted) that, under the limitations of the taxing power of the States imposed by the national banking act,[3] a State is not authorized to tax the stock of a bank *in solido*, or to authorize it to be so taxed by the city within which it does business; but that only the shares of individual owners residing in the city are taxable, and that they must be taxed separately, in order that the shareholder may be enabled to secure the *deduction* from their value of the amount of his personal indebtedness, which deduction is allowed by the State revenue law in other cases.[4] Under the revenue law of North Carolina in force in the year 1882, it was held that a tax laid upon shares in a railway company, after the expiration of an exemption elsewhere referred to[5] was assessable against each shareholder, and was not to be assessed against the corporation and paid by it.[6]

[1] Lionberger *v.* Rowse, 43 Mo. 67; *s. c.* affirmed on other grounds, 9 Wall. (U. S.) 468.

[2] New Orleans Cotton Exchange *v.* Assessors, 35 La. An. 1154.

[3] Rev. Stats. U. S., § 5219; *ante*, § 2856.

[4] First Nat. Bank *v.* Richmond, 39 Fed. Rep. 309, opinion by Hughes, J.; National Bank *v.* Richmond, 42 Fed. Rep. 877 (under another statute), opinion by Bond, J. Some doubt would seem to attend the soundness of the second of these decisions, as the statute of Virginia set out in the opinion was evidently framed to meet the difficulty of the first decision, and to open the road to the shareholder to secure the deduction referred to. That any scheme of State taxation would be invalid which deprived the corporate shareholder of the same deductions which were allowed in favor of moneyed capital in the hands of other citizens of the State, is unquestionable, in view of many Federal holdings. Supervisors *v.* Stanley, 105 U. S. 305; *ante*, § 2868, *et seq.*

[5] *Ante*, § 2829.

[6] Raleigh &c. R. Co. *v.* Wake Co., 87 N. C. 414, 426.

§ 2916. Corporation may Contest Such a Tax.— If a tax against the shareholders can be lawfully laid and enforced against the corporation, it must follow, on correlative lines of reasoning, that the corporation has a *locus standi* in court to contest the validity of the tax, in particular cases, upon any ground which would be available to the shareholder if the tax had been laid directly against him. It would be contrary to the plainest justice for the State to say to the corporation, "We will enforce against you this tax laid upon the shares of your members, but we will not allow you to be heard in court in their behalf for the purpose of making it appear that the tax is improperly laid." It is therefore believed that all the courts either expressly or impliedly recognize the right of the corporation to make any defense available to the shareholders against taxes thus laid and sought to be enforced. Thus, in a case in Pennsylvania, it was held that a corporation has a legal standing in court to contest the constitutionality of a law requiring it to deduct, from the interest due on its obligations, the amount of the tax on them, and pay it into the treasury, instead of paying it to the holders of the securities.[1]

§ 2917. Taxation of Shares Held under Mortgage or Pledge.— Under a statutory system under which the tangible property of corporations is assessed to the corporation at its place of residence, and its capital is assessed to its shareholders distributively, and each shareholder is allowed a deduction to the extent of his proportion of the value of the assessed property of the corporation,— it has been held that railroad shares, held by a bank *in pledge*, as collateral security for the payment of a debt, are not taxable to the bank, but are taxable to the mortgagor, he being their owner.[2] But, under a similar system, where a railroad company *issued directly to a bank* a certificate for fifty shares of its capital stock, to secure its note for five thousand dollars, discounted by the bank, it was held that the bank was rightly assessed as the *absolute owner* of the shares,

[1] Commonwealth *v.* Delaware Div. Canal Co., 123 Pa. St. 594; *s. c.* 16 Atl. Rep. 584; 2 L. R. A. 798; 46 Phila. Leg. Int. 191; 23 W. N. C. 216. Compare Dodge *v.* Woolsey, 18 How. (U. S.) 331.

[2] Waltham Bank *v.* Waltham, 10 Met. (Mass.) 334.

and that *parol evidence* would not be heard to show that its title to them was conditional merely. The opinion of the court, so holding, is somewhat obscure; but the court seems to have been impressed with the conclusion that the note, which was secured by the pledge of the shares, had become a part of the capital of the bank, so that it would be reached for taxation through the taxation of the shares of the bank in the hands of its shareholders; and that, the shares of the railroad company, issued to the bank to secure the note, would escape taxation altogether, unless taxed as the property of the bank.[1] The difficulty of this case, however, lay in the fact that the shares were issued by the corporation directly to the bank, which made the bank their legal owner in form, and probably as a matter of law; since there could be no other legal owner, as they had been issued to no other person, and as the corporation could not own its own shares.[2] An ordinary pledge of corporate shares, by the holder to whom the certificate has been issued or transferred, to his creditor to secure his debt, stands on a very different footing. Such a pledge, as we have already seen, does not, in the absence of an express agreement to that effect, pass the legal title to the pledgee, but that title, together with the right to vote, remains in the pledgor.[3] It is therefore a sound conclusion that corporate shares pledged as collateral, with power to the pledgee to transfer them to his own name and to sell them if the loan is not paid, but which remains on the books in the name of the pledgor, are taxable in the name of the latter.[4] So, it has been held that a person who subscribes for shares in a banking corporation, and pays a part of the amount of his subscription, and then conveys the shares to the bank to secure the residue, is liable to be taxed on the amount thus paid in, as the owner of the stock.[5]

[1] Augusta Bank *v.* Augusta, 36 Me. 255.

[2] *Ante*, § 2054, *et seq.* In Waltham Bank *v.* Waltham, 10 Met. (Mass.) 334, the pledgor of the shares seems to have procured the corporation to issue a new certificate directly to the pledgee "as collateral security for S. F. Belknap's note." The case turned chiefly on the language of statutes.

[3] *Ante*, § 2619.

[4] Ratterman *v.* Ingalls, 48 Oh. St. 468; *s. c.* 28 N. E. Rep. 168; aff'g *s. c.* 24 Oh. L. J. 433.

[5] Tucker *v.* Aiken, 7 N. H. 113.

2918. Lien of Taxes upon Shares. — The lien of taxes laid upon corporate shares depends upon particular statutory systems, and perhaps no general principle can be stated which runs through the subject. Until the Missouri act of March 10, 1871, providing a uniform system of assessing and collecting taxes on railroads, railroad property was not, by the general law, subject to taxation in specie. The only form of taxation provided for was a tax against the shareholders upon their shares; and for this there was *no lien on the property of the company*.[1] An *actual levy* or *seizure* will have substantially the effect of a lien; but this will not be in a strict sense a possessory lien, since shares of stock, being incorporeal, cannot be taken into custody, though there may be a symbolical seizure and custody, where the certificate itself is seized. In a case in Louisiana, the statute provided for the assessment of the shares against the corporation in the usual way, elsewhere described in this article,[2] by the officers of the corporation furnishing a list of the shareholders to the assessor, by the assessor notifying the bank of the assessment, after which the taxes thus assessed against the bank were payable by the bank. Under this statute the following question was supposed to be raised on the record in one case: If the corporation has sufficient *possession* of the shares, notwithstanding the certificates evidencing the ownership of the respective shareholders were not in its keeping or actual custody, to enable the assessor to make a *valid assessment* of them at the *situs* of the corporation, is not that possession sufficient to enable the tax collector to effect a *valid seizure* of them in the same manner? Though it seems to the author that the question was merely a speculative one, yet the court dealt with it by reasoning, in substance, and on the authority of a previous decision of the same court discussing the mode of levying a *fieri facias* upon bank shares,[3] that shares of stock in a corporation, evidenced by a certificate in the hands of the shareholder, are *incorporeal rights* in the funds and assets of the corporation, which can be seized, either by taking possession of the certificates themselves, or by seizing the interest of the shareholder in

[1] State *v.* St. Louis &c. R. Co., 77 Mo. 202.

[2] *Ante*, § 2914.

[3] Harris *v.* Bank of Mobile, 5 La. An. 538.

the assets and property of the corporation, by giving notice to the proper officers thereof. And further, that the inability of a tax collector to seize the corporeal evidence of the right, — that is to say, to get possession of the certificate, — does not prevent the collector from seizing the right itself, by notifying the keeper of the subject-matter of the right, that is by notifying the corporation. The court further reasoned that certificates of shares, not being negotiable, cannot be sold to the prejudice of the lien created by such a seizure.[1]

§ **2919. Some Questions of Procedure.** — It is not designed, in treating of the subject of the taxation of corporate shares, to enter into questions of procedure, arising under the statutory systems of the different States; but the following, which have come under the eye of the author, seem worth preserving: Where the sole defense made to an information under the Kentucky "Auditor's Agent Act"[2] to compel defendant to list shares of corporate stock owned by him, for taxation, is that the stock is not liable to taxation, an objection that the information proceeds for an assessment of the shares of stock, as such, for taxation, while, if taxable at all, they are by law taxable as surplus only, is *waived.*[3] - - - - In Pennsylvania, a manufacturing corporation, claiming as exempt from taxation shares of stock in other corporations owned by it, on the ground that they were taken in exchange for its own manufactured products, has the *burden* of establishing that fact.[4]

[1] Parker *v.* Sun Ins. Co., 42 La. An. 1172; *s. c.* 8 South. Rep. 618; 32 Am. & Eng. Corp. Cas. 334.

[2] Ky. Act of April 29, 1880.

[3] Whitaker *v.* Brooks, 90 Ky. 68; *s. c.* 13 S. W. Rep. 355.

[4] Commonwealth *v.* Westinghouse Air Brake Co., 151 Pa. St. 276; *s. c.* 24 Atl. Rep. 1111; *Id.* 1113. How far courts will correct *erroneous valuations:* Raleigh &c. R. Co. *v.* Wake Co., 87 N. C. 414, 422.